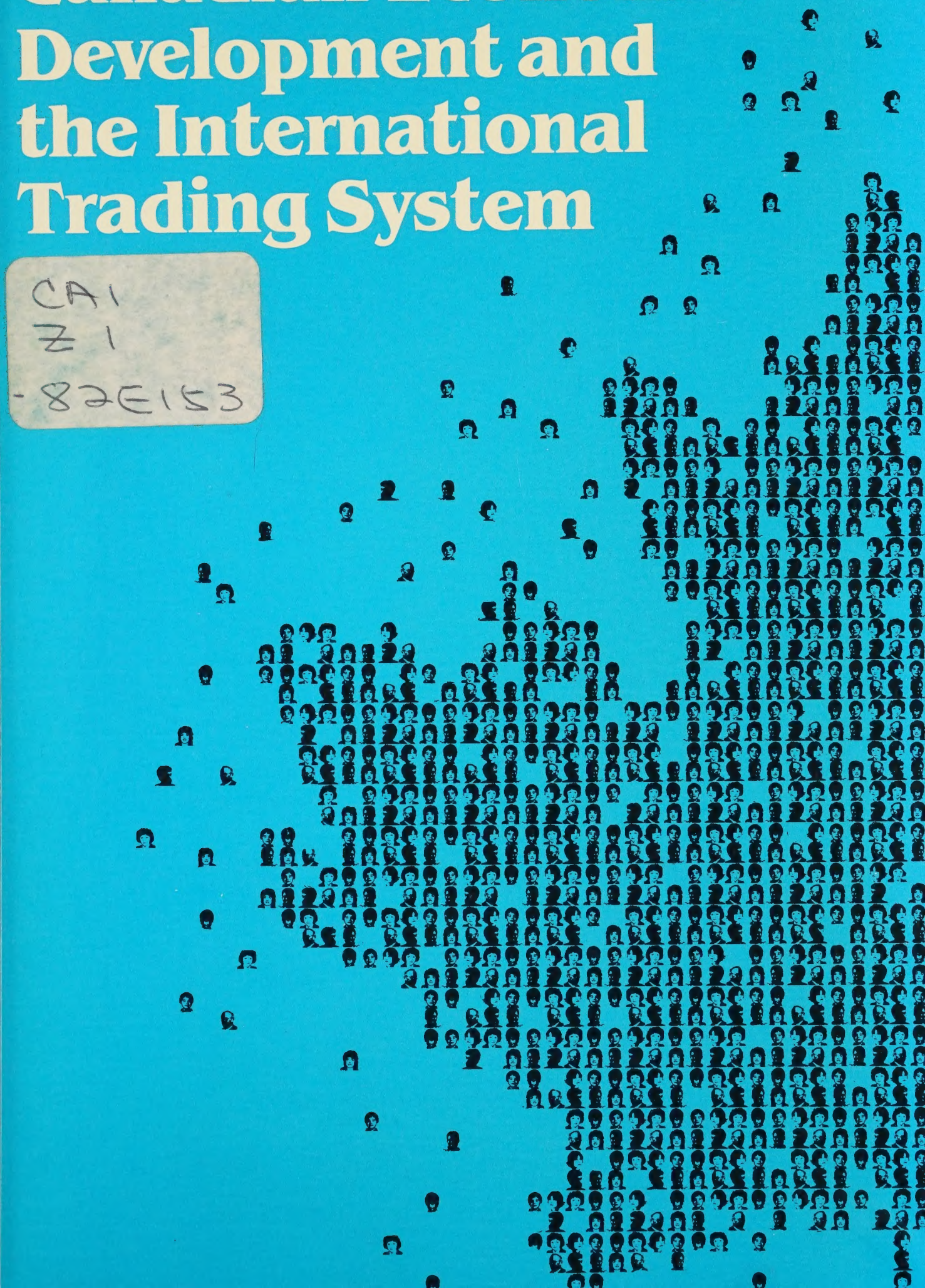
MICHAEL M. HART

Canadian Economic Development and the International Trading System



Canadian Economic Development and the International Trading System

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Canadian Economic Development and the International Trading System: Constraints and Opportunities

MICHAEL M. HART

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FOREWORD

When the members of the Rowell-Sirois Commission began their collective task in 1937, very little was known about the evolution of the Canadian economy. What was known, moreover, had not been extensively analyzed by the slender cadre of social scientists of the day.

When we set out upon our task nearly 50 years later, we enjoyed a substantial advantage over our predecessors; we had a wealth of information. We inherited the work of scholars at universities across Canada and we had the benefit of the work of experts from private research institutes and publicly sponsored organizations such as the Ontario Economic Council and the Economic Council of Canada. Although there were still important gaps, our problem was not a shortage of information; it was to interrelate and integrate — to synthesize — the results of much of the information we already had.

The mandate of this Commission is unusually broad. It encompasses many of the fundamental policy issues expected to confront the people of Canada and their governments for the next several decades. The nature of the mandate also identified, in advance, the subject matter for much of the research and suggested the scope of enquiry and the need for vigorous efforts to interrelate and integrate the research disciplines. The resulting research program, therefore, is particularly noteworthy in three respects: along with original research studies, it includes survey papers which synthesize work already done in specialized fields; it avoids duplication of work which, in the judgment of the Canadian research community, has already been well done; and, considered as a whole, it is the most thorough examination of the Canadian economic, political and legal systems ever undertaken by an independent agency.

The Commission's research program was carried out under the joint direction of three prominent and highly respected Canadian scholars: Dr. Ivan Bernier (*Law and Constitutional Issues*), Dr. Alan Cairns (*Politics and Institutions of Government*) and Dr. David C. Smith (*Economics*).

Dr. Ivan Bernier is Dean of the Faculty of Law at Laval University. Dr. Alan Cairns is former Head of the Department of Political Science at the University of British Columbia and, prior to joining the Commission, was William Lyon Mackenzie King Visiting Professor of Canadian Studies at Harvard University. Dr. David C. Smith, former Head of the Department of Economics at Queen's University in Kingston, is now Principal of that University. When Dr. Smith assumed his new responsibilities at Queen's in September, 1984, he was succeeded by Dr. Kenneth Norrie of the University of Alberta and John Sargent of the federal Department of Finance, who together acted as Co-directors of Research for the concluding phase of the Economics research program.

I am confident that the efforts of the Research Directors, research coordinators and authors whose work appears in this and other volumes, have provided the community of Canadian scholars and policy makers with a series of publications that will continue to be of value for many years to come. And I hope that the value of the research program to Canadian scholarship will be enhanced by the fact that Commission research is being made available to interested readers in both English and French.

I extend my personal thanks, and that of my fellow Commissioners, to the Research Directors and those immediately associated with them in the Commission's research program. I also want to thank the members of the many research advisory groups whose counsel contributed so substantially to this undertaking.

DONALD S. MACDONALD

At its most general level, the Royal Commission's research program has examined how the Canadian political economy can better adapt to change. As a basis of enquiry, this question reflects our belief that the future will always take us partly by surprise. Our political, legal and economic institutions should therefore be flexible enough to accommodate surprises and yet solid enough to ensure that they help us meet our future goals. This theme of an adaptive political economy led us to explore the interdependencies between political, legal and economic systems and drew our research efforts in an interdisciplinary direction.

The sheer magnitude of the research output (more than 280 separate studies in 72 volumes) as well as its disciplinary and ideological diversity have, however, made complete integration impossible and, we have concluded, undesirable. The research output as a whole brings varying perspectives and methodologies to the study of common problems and we therefore urge readers to look beyond their particular field of interest and to explore topics across disciplines.

The three research areas, — *Law and Constitutional Issues*, under Ivan Bernier; *Politics and Institutions of Government*, under Alan Cairns; and *Economics*, under David C. Smith (co-directed with Kenneth Norrie and John Sargent for the concluding phase of the research program) — were further divided into 19 sections headed by research coordinators.

The area *Law and Constitutional Issues* has been organized into five major sections headed by the research coordinators identified below.

- Law, Society and the Economy — *Ivan Bernier and Andrée Lajoie*
- The International Legal Environment — *John J. Quinn*
- The Canadian Economic Union — *Mark Krasnick*

- Harmonization of Laws in Canada — *Ronald C.C. Cuming*
- Institutional and Constitutional Arrangements — *Clare F. Beckton and A. Wayne MacKay*

Since law in its numerous manifestations is the most fundamental means of implementing state policy, it was necessary to investigate how and when law could be mobilized most effectively to address the problems raised by the Commission's mandate. Adopting a broad perspective, researchers examined Canada's legal system from the standpoint of how law evolves as a result of social, economic and political changes and how, in turn, law brings about changes in our social, economic and political conduct.

Within *Politics and Institutions of Government*, research has been organized into seven major sections.

- Canada and the International Political Economy — *Denis Stairs and Gilbert Winham*
- State and Society in the Modern Era — *Keith Banting*
- Constitutionalism, Citizenship and Society — *Alan Cairns and Cynthia Williams*
- The Politics of Canadian Federalism — *Richard Simeon*
- Representative Institutions — *Peter Aucoin*
- The Politics of Economic Policy — *G. Bruce Doern*
- Industrial Policy — *André Blais*

This area examines a number of developments which have led Canadians to question their ability to govern themselves wisely and effectively. Many of these developments are not unique to Canada and a number of comparative studies canvass and assess how others have coped with similar problems. Within the context of the Canadian heritage of parliamentary government, federalism, a mixed economy, and a bilingual and multicultural society, the research also explores ways of rearranging the relationships of power and influence among institutions to restore and enhance the fundamental democratic principles of representativeness, responsiveness and accountability.

Economics research was organized into seven major sections.

- Macroeconomics — *John Sargent*
- Federalism and the Economic Union — *Kenneth Norrie*
- Industrial Structure — *Donald G. McFetridge*
- International Trade — *John Whalley*
- Income Distribution and Economic Security — *François Vaillancourt*
- Labour Markets and Labour Relations — *Craig Riddell*
- Economic Ideas and Social Issues — *David Laidler*

Economics research examines the allocation of Canada's human and other resources, the ways in which institutions and policies affect this

allocation, and the distribution of the gains from their use. It also considers the nature of economic development, the forces that shape our regional and industrial structure, and our economic interdependence with other countries. The thrust of the research in economics is to increase our comprehension of what determines our economic potential and how instruments of economic policy may move us closer to our future goals.

One section from each of the three research areas — The Canadian Economic Union, The Politics of Canadian Federalism, and Federalism and the Economic Union — have been blended into one unified research effort. Consequently, the volumes on Federalism and the Economic Union as well as the volume on The North are the results of an interdisciplinary research effort.

We owe a special debt to the research coordinators. Not only did they organize, assemble and analyze the many research studies and combine their major findings in overviews, but they also made substantial contributions to the Final Report. We wish to thank them for their performance, often under heavy pressure.

Unfortunately, space does not permit us to thank all members of the Commission staff individually. However, we are particularly grateful to the Chairman, The Hon. Donald S. Macdonald; the Commission's Executive Director, J. Gerald Godsoe; and the Director of Policy, Alan Nymark, all of whom were closely involved with the Research Program and played key roles in the contribution of Research to the Final Report. We wish to express our appreciation to the Commission's Administrative Advisor, Harry Stewart, for his guidance and advice, and to the Director of Publishing, Ed Matheson, who managed the research publication process. A special thanks to Jamie Benidickson, Policy Coordinator and Special Assistant to the Chairman, who played a valuable liaison role between Research and the Chairman and Commissioners. We are also grateful to our office administrator, Donna Stebbing, and to our secretarial staff, Monique Carpentier, Barbara Cowtan, Tina DeLuca, Françoise Guilbault and Marilyn Sheldon.

Finally, a well deserved thank you to our closest assistants: Jacques J.M. Shore, *Law and Constitutional Issues*; Cynthia Williams and her successor Karen Jackson, *Politics and Institutions of Government*; and I. Lilla Connidis, *Economics*. We appreciate not only their individual contribution to each research area, but also their cooperative contribution to the research program and the Commission.

Ivan Bernier
Alan Cairns
David C. Smith

This monograph on the GATT legal system, Douglas Johnston's monograph on the law of the sea and a third volume containing four essays designed to survey and analyze other salient aspects of the legal framework governing Canada's foreign economic relations are the products of the Royal Commission's Legal and Constitutional Research Program. These three volumes comprise the output of a branch of the program that was designed to examine how the international legal framework for multilateral and bilateral relations is likely to shape Canada's future economic development. Canada's economic future depends on the effectiveness of a global legal system which promotes the openness, stability and dynamism of international markets. This system encompasses a number of formal institutions such as the GATT, the International Monetary Fund and the United Nations Convention on the Law of the Sea; it also includes a diverse range of more specialized arrangements designed to regulate particular transactions or economic activities with significant transnational impacts or consequences, such as foreign direct investment and the transfer of technology.

The monographs and essays in this and its companion volumes attempt to analyze the strengths and weaknesses of the present international legal framework, and to assess the likely effects of future legal and institutional developments on Canada's economic and political interests. The research program was designed to educate a broad non-specialist audience in the basic legal norms and decision-making procedures governing the most economically important aspects of Canada's links with the global economy: (a) trade in goods and services; (b) the utilization of marine resources and national regulatory powers applica-

ble to coastal and offshore areas; (c) the transfer of technology and intellectual property rights; (d) Canada–U.S. economic relations; and (e) inward and outward flows of investment capital, especially controlling equity interests held by foreign residents. The authors of these studies have also examined the existing domestic arrangements for foreign economic policy making in Canada, and their work identifies and analyzes the basic options for designing domestic policies and institutions in response to the changes emerging from the evolving global legal framework. Moreover, all the authors advance concrete proposals for substantive and procedural reforms to the international legal system, and to the domestic rules and processes that shape Canada's foreign economic policies.

Michael Hart's monograph analyzes the existing legal framework governing national laws and regulations that directly or indirectly affect international trade in goods between Western developed nations. The focus of this study is the relationship between Canada's legal obligations, principally under the GATT, and the substantive content and institutional processes of Canadian economic development policies. The first two chapters describe the major multilateral and bilateral institutions and arrangements that govern the key aspects of foreign economic relations (i.e., trade, money, aid, foreign direct investment) among the developed and developing capitalist nations. This introductory material clarifies the diversity of Canada's legal obligations, and the wide variety of international institutions that make and enforce these norms.

The author's main concern is with the GATT legal system, which has been the primary institutional vehicle for the pursuit of Canadian trade policy objectives during the postwar era. Hart surveys the strengths and weaknesses of the GATT legal framework from the standpoint of Canadian economic development goals, drawing from both the existing academic literature and his extensive experience as a trade policy analyst and negotiator with the Department of External Affairs. His analysis focusses on the substantive and procedural limitations which the GATT imposes on the major legal instruments for the conduct of national economic development or industrial policies — tariffs, subsidies, unfair trade practice regulations, quotas and other regulations that discriminate against foreign competitors. Hart concludes that Canada has derived substantial economic and political benefits by agreeing to accept legally binding constraints on its freedom to deploy tariff and non-tariff measures in aid of domestic economic development. He also argues that much remains to be done in elaborating and improving the performance of the GATT normative framework, particularly in the rules governing safeguard protection and dispute resolution procedures. The author concludes with a number of concrete and original proposals for legal and administrative reform that are designed to advance the pursuit of Canada's trade and industrial policy goals.

JOHN QUINN

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Editing the monographs and essays in these three volumes was an intellectually rewarding task, not only because of the excellence of the authors' work, but also because of the many valuable exchanges and discussions with colleagues and friends who offered their assistance during the course of the Royal Commission's research program. Dean Ivan Bernier of the Laval Law School deserves special mention. As the director of the research program, he helped to conceive the overall project and to design all the studies that appear in these three volumes. His intellectual and administrative contributions throughout the project were invaluable. Further special thanks are due to the Commission staff who performed an indispensable role in bringing these studies to completion, particularly my friend Jacques Shore who was an unflagging source of help and encouragement.

During the project, I was fortunate to have the assistance of several external advisers who commented on manuscripts and made many helpful suggestions to the authors. Their varied knowledge and experience on matters of international law and economics was a signal contribution to the project. The individuals who served as research advisors were:

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J.Q.

Chapter 1

Canada in an Interdependent World

> Something of Canada's essence is defined by its external relations. Much of its economic structure can be explained only in terms of its external trade.
> — Gordon Commission, 1957

Canada's economic development, as well as government economic development policies, are significantly conditioned by factors external to Canada. As a relatively small, "open" economy, and as a large world trader, Canada is vulnerable to outside influences on its trade and economic performance. In order to foster stability and predictability in some of these forces, successive Canadian governments have given strong support to the development of formal international rules and relationships. In pursuing this objective, shared with many other governments, Canada has agreed to constraints on its own freedom of action because other international actors have sought stability and predictability in Canadian policies and actions in return for stability and predictability in their own. The result has been increasing interdependence among governments in managing their domestic economies.

In considering the interaction between Canada and its trading partners within a complex framework of multilateral and bilateral rules, it is important to realize that, after almost 40 years of concerted multilateralism and growing international trade, international integration and interdependence are now so far advanced that no responsible government can afford to ignore the system and go it alone. The contemporary global economy is based on a system of no escape. Governments no longer have the option of adopting domestic policy measures that ignore their external relations. When they sometimes do, they pay heavily for it. The point was well put by William Mulholland, chairman of the Bank of Montreal, when he said:

> The world has come to operate much more as a single unit in the past thirty-five years than at any other time in history. We must now accept that interdependence is a characteristic of the present world. This is no longer a matter of choice; it is a fact of life. . . . In this day and age, espousal of economic nationalism fares in the same category as membership in the Flat Earth Society.[1]

Canada has always been sensitive to and dependent on the nature and quality of its international relations. Canadian well-being depends on the health of the world trade, payments and investment systems, the stability provided by collective security arrangements, and access to foreign capital, research, technology and cultural developments, especially from the United States. This has been one of several constant factors in our international relations, deriving from national values, tradition, geopolitical circumstance and economic interest.

Since the end of World War II, Canada has expanded its horizons as an independent, bilingual, multicultural country. It has cultivated bilateral ties to Europe, Japan and the Third World. It has sought careful management of Canada–U.S. relations. At the same time, participation in the Summit, UN, GATT, IMF, NATO, Commonwealth, Francophonie and other multilateral institutions and forums is a purposeful expression of Canada's commitment to an open international trade and payments system, to the collective security arrangements which safeguard its sovereignty and independence, and to an international political order which can contribute to greater global social justice.

An illustration of the evolution of the Canadian government's involvement in the international system is afforded by the growth in the size and range of activities of the Department of External Affairs. At the outbreak of World War II, headquarters staff comprised less than two dozen officers attached to the Prime Minister's Office and located in the East Block. A few missions abroad (notably London, Paris, Washington and Tokyo) required a few dozen additional officers. Today, the establishment at some of the larger embassies is greater than the whole foreign service of two generations ago. There are now some 120 missions in 80 different countries. Headquarters cannot be contained within a four-tower office complex. Senior management alone is larger than the whole headquarters staff in 1939. Three ministers provide political direction. While in part explained by the general growth in the public service, it also demonstrates the much broader range of bilateral and multilateral activities and relationships requiring day-to-day management and direction, as well as the growing complexity of international affairs.

Concomitant with this growth in international relationships has developed a dispersal or diffusion of responsibility and authority — and an anxiety about coordination and improved channels of communication. No individual politician or official can now fully grasp the range of international activities, rights, obligations, constraints and oppor-

tunities with which modern governments must contend. Machinery has been developed to overcome this difficulty but with mixed results.[2] Consider the easy relationships that existed between Prime Minister Mackenzie King, his Cabinet and such senior trade policy officials as Dana Wilgress, Norman Robertson and Hector McKinnon in the 1930s and 1940s: instructions for important negotiations such as the 1935 and 1938 Canada–U.S. negotiations were worked out directly between Cabinet and negotiator and the results reported directly by the negotiator to Cabinet; ministers were intimately involved with the process and the substance. Today, elaborate machinery exists to prepare and review massive documents for Cabinet consideration and decision, frustrating both ministers and officials and stimulating a bureaucratic process many see as counterproductive and out of control. A broader understanding of the nature and development of, and the reasons for, Canada's extensive range of international commitments may assist in directing this process along more productive paths.

Trade and Economic Performance

Some 30 percent of the Canadian gross national product is generated by the export of goods and services. This means that almost half of the goods produced in Canada are either directly exported or incorporated in goods for export. This percentage is significantly higher in a number of Canada's leading competitive industries. To promote efficiency and competitiveness in Canada, Canadians rely to a considerable extent on the import of foreign technologies, machinery, equipment and other industrial inputs. Canadian consumers are also dependent on a range of imported goods which are not produced in Canada or which are not produced in sufficient quantities, in a sufficient range of qualities, or at competitive prices to supply the Canadian market. This reliance on both exports and imports is a basic characteristic influencing the performance of the Canadian economy.

Canada's trade performance plays a vital role in balancing the demand and supply of foreign exchange. Traditionally, Canada has registered a substantial merchandise trade surplus which has helped to offset Canada's deficit in service trade, to pay for foreign technologies, and to permit government and private sector borrowing to finance economic development in Canada. Trade is thus a vital link between the Canadian economy and the international competitive environment. It is through the medium of trade that Canadian producers have become integrated into world markets.

It is trade and the effective deployment of trade policy which allows Canadian producers to overcome the problems of establishing efficient-scale production in an economy of only 24 million people. As a major industrialized country without tariff-free access to a domestic market of

at least 100 million people, this fact is of critical importance. It requires that the right policy environment be created, both domestically and internationally, within which sound business decisions may be taken. In order to plan and invest, individual producers need assurance that their access to foreign markets will be secure over the long term. They also need to know what the rules of the game are regarding imports into Canada. They expect that Canadian laws to counter the use of unfair trade practices by other countries will be applied in a fair and expeditious manner. The consistent application of the trade policy instruments at the government's disposal is essential to the establishment of business confidence.

George Shultz, the U.S. secretary of state, has written that "nothing is more domestic than international trade policy," for it is here that the potential efficiency gains from free trade intersect with the political process and the issue of equity, i.e., the preservation of jobs and regional balance. In this regard, Canada is in a unique position among major traders. International trade is more important to Canada than to countries such as the United States and Japan, and international trade patterns affect the various regions of Canada differently. At the same time, the existence of a federal system in Canada necessitates careful nurturing of a national consensus on economic issues and constrains somewhat the capacity of the federal government to influence the development of the national economy, e.g., the federal government controls less than half of government expenditure in Canada (42 percent), the lowest among countries in the Organization for Economic Cooperation and Development (OECD).

As a trading nation, Canada has both strengths and weaknesses. It is endowed with a well-educated and adaptable work force, a stable form of government, and an enviable supply of natural resources. Canada has a plentiful supply of a range of energy sources (oil, gas, hydro, nuclear), ready access to advanced technology, a stable and highly developed financial system, and a generally well-developed infrastructure. Canada is perceived to be a stable and reliable supplier, especially of resource-based products, and can count on an efficient and diversified primary industry. It has, in the past half-century, developed a sophisticated manufacturing base capable of supplying a wide range of products for both domestic and international markets. It enjoys relative proximity to its major markets and suppliers, and marketing opportunities are enhanced by participation in an internationally integrated corporate structure.

These strengths are offset to some extent by certain weaknesses or perceived shortcomings. Indeed, some of these weaknesses are closely related to strengths. The domestic market is relatively small and fragmented and Canada's population is widely dispersed in a thin zone hugging the U.S. border. As a result, difficulties can be experienced in

achieving an optimum allocation of resources — e.g., there may be unemployment in one region but shortages in another. Canada's climate in most instances is forbidding and adds significantly to the cost of doing business here. Canada has limited entrepreneurial strength and suffers from a perceived branch-plant syndrome, an inadequate research and development performance, and persistent labour strife. Some observers consider that there may be a lack of common purpose among government, industry, and labour to meet the opportunities provided by its strengths. Because of Canada's proximity to the United States, it may have become overly dependent on that country, both as a supplier and as a market.

The Purpose of the Study

This study considers the relationships between the federal government's pursuit of economic development through various policy instruments and the constraints on the design and implementation of these policies resulting from Canada's obligations under international agreements and other arrangements. More generally, this paper discusses Canada's relationship with other countries as a fully integrated member of the world trade and economic system.

The 1983 federal government publication *Canadian Trade Policy for the 1980s* posited two fundamental objectives of Canadian trade policy:

- the development of a stronger, more efficient, productive, competitive, growing and non-inflationary domestic economy, the increased per capita wealth of which is shared by Canadians from all regions of the country; and
- the promotion of a more stable and open international trading environment within which competitive Canadian and foreign firms alike are encouraged to plan, invest and grow with confidence.[3]

This study is about the interaction between these two objectives. More precisely, it discusses how the search for a stable international environment affects the formulation and operation of domestic economic development policies.

The study is organized into five parts:

1. an overview of the major multilateral and bilateral instruments and institutions that give rise to rights and obligations in international economic relations and the making of domestic economic policy;
2. an appreciation of the important role of international practice in giving effect to international commitments, with particular reference to the United States, the European Community and Japan;
3. an examination of the interrelationship between international commitments and economic policy making in Canada, drawing on the experience in budget making and a range of industrial policy instru-

ments (tariffs, subsidies, contingency protection, government procurement and export credits);

4. a detailed account of the evolution of international rules relating to emergency safeguards and the problems of international trade in textiles and clothing. This is the core of the study and provides insight into both the constraints and the opportunities provided to Canada by full participation in a rule-oriented international system; and
5. general conclusions and suggestions for the future course of Canadian foreign economic policy making.

Chapter 2

Canada's International Rights and Obligations

> Our economic interdependence compels us to understand that many of our problems transcend international borders; we must solve them together if they are to be solved at all.
>
> — Pierre Elliot Trudeau,
> Address to the International Monetary Fund, 1982

It is not the purpose of this chapter to describe in detail the full range of Canada's international rights and obligations. To do so would require a major study. A number of works now exist which provide basic information and analysis covering various aspects.[4] Rather, this chapter seeks to describe the kinds of rights and obligations which Canada has worked out with its trading partners over the years, to suggest the reasons for such a network of rights and obligations, and to consider their effect on Canada.

The terms rights and obligations are used here in their broadest sense. As an active participant in the world trading order, Canada has accepted a wide range of obligations, arrangements, commitments, understandings and undertakings, ranging from the very specific to the most general. Canada's trading partners have accepted similar obligations by which Canada has gained rights, expectations and promises. Canada's economic development policies are directly influenced by this system, and Canada in turn can influence the policies of its trading partners through this system.

For purposes of convenience, the rights and obligations discussed below have been classified into those which can be considered multilateral and those which are largely bilateral. It should be understood, however, that the two categories are not exclusive of each other. Rather, Canada pursues bilateral relations within a multilateral framework.

When addressing matters between them, governments may involve bilateral or multilateral commitments or both, or seek new bilateral or multilateral undertakings. The result is that, for most relationships, there exists a continuum of bilateral and multilateral rights and obligations which reinforce each other and at times provide alternative approaches to issues.

The various multilateral institutions and conventions operate largely independently of each other and seek to provide forums for consultations or negotiations and a standard of behaviour for a particular sector of international activity. While there may appear at times to be overlap and conflict, they are in fact largely integrated with a view to fostering general cooperation. The most obvious example of this interlinkage is to be found in the relationship that exists between the International Monetary Fund (IMF) and the General Agreement on Tariffs and Trade (GATT). The IMF is primarily responsible for international monetary and financial affairs, and the GATT concentrates on international trade matters. The architects of the postwar multilateral trade and payments system recognized that not all trade problems could be resolved through trade instruments and not all financial problems through monetary instruments. They realized further that it is useless to establish rules governing such areas as tariffs, dumping and import controls, if countries remain free to manipulate their exchange rates to meet narrow ends at the expense of others. They therefore established links between the two organizations and their respective policy responsibilities in an attempt to ensure effective cooperation leading to mutual support. The same holds true for most other institutions and conventions.

Historical Overview

Canada traces the origins of its foreign economic policy to colonial experience, first as part of French North America and then as part of the British Empire. Little of the former remains in the network of rights and obligations Canada became heir to. The heritage of the latter, however, remains significant, particularly in trade and economic matters. For example, the 1654 Treaty of Peace and Commerce between Great Britain and Sweden and the 1794 Treaty of Amity, Commerce and Navigation (Jay's Treaty) between the United Kingdom and the United States remain partially in force today.

Even after gaining status as an independent dominion in 1867, Canada did not gain full sovereignty over its external relations. Canadian officials participated in various negotiations with Canada's emerging trading partners, but British ambassadors signed the resulting treaties, such as, for example, the 1909 Canada–U.S. Water Boundaries Agreement. The first treaty signed by Canada in its own right was the Treaty of Versailles in 1919. The 1923 Canada–U.S. Halibut Fisheries Agreement constitutes

the first bilateral treaty Canada signed in its own right. Full acquisition of Canadian sovereignty, however, was not achieved until the Statute of Westminster in 1932, by which time Canada had already entered into a number of bilateral trade agreements. Thereafter, Canada's treaty-making authority resulted in a plethora of international rights and obligations, beginning with two important trade agreements with the United States in 1935 and 1938.

Canada's commercial policy and external relations developed along similar lines. Of the colonies that made up Confederation in 1867, each had pursued its own commercial policy, but subject to British approval. The customs union that resulted from Confederation enjoyed more freedom but still relied on Britain for the external expression of that policy. In the first 50 years of Canada's history as a nation, a good deal of effort was expended on improving access to foreign markets for Canada's staple products, including to the markets of the United States, Japan, Europe and Latin America. These efforts met with mixed success but growing rights and obligations; as noted above, many of them were negotiated by the United Kingdom. A Trade Commissioner Service was established in 1892, long before Canada had its own diplomatic service, which in turn stimulated a growing network of relationships formalized in arrangements and conventions. In the 1920s and 1930s, concurrent with the growing tide of protectionism associated with the Great Depression, Canada negotiated more and more on its own and pursued a more independent foreign commercial policy. The pattern of Canadian trade had altered considerably by this time. Britain's position as both a market for commodity exports and a source of manufactured goods had declined and the United States had replaced Britain as Canada's premier trading partner.

World War II marked Canada's coming of age as a sovereign nation. Canada made a large contribution to the war effort, built up a respectable manufacturing sector to produce war materiel and established lasting relationships with a growing range of countries. By the end of the war, Canada was ready to assume an important and influential role in world affairs, and particularly in trade and financial affairs.

The disruption of the world financial and trading system, experienced first through depression and then through war in the 1930s and 1940s, made Canada's postwar political leaders into confirmed multilateralists. They were convinced that the bilateralism expressed in the beggar-thy-neighbour policies in the 1930s had contributed directly to war. They believed that, in a world of strong multilateral institutions, the risks of protectionism and isolationism could be reduced significantly and could provide an opportunity for Canada to influence directly the policies of the major powers in directions favourable to Canada's further development as a nation. Thus Canadian officials played a large role in designing the postwar multilateral trade and payments system, the most prominent

units of which are the International Bank for Reconstruction and Development (IBRD), the IMF and GATT, within a larger United Nations system.[5] This system also strongly conditioned the types of links Canada would forge with a growing range of individual trading partners.

The institutions founded in the 1940s were dedicated to the establishment of a liberal multilateral order based on the free flow of goods and services and on convertible currencies to permit multilateral settlement of national accounts. Central to the system were the twin pillars of the International Monetary Fund and the General Agreement on Tariffs and Trade (instead of the International Trade Organization, which failed to come into being). The two institutions were built on the proposition that a liberal system based on agreed rules would lead to prosperity and growth for its members and in turn contribute to peace and stability. They assumed the economic theory of comparative advantage and the premise that the competitive forces at work in international trade and the effective operation of the price system would benefit the world economy and the economies of individual countries. The postwar planners realized that a world of strong multilateral institutions would entail some sacrifice of sovereignty, but they regarded this as a small price to pay for a system which could help to prevent a recurrence of the chaos and disorder of the previous 20 years. Generally speaking, the system has worked and has contributed to the increasing international division of labour, to a rapid growth of world production and international trade, and to extensive interdependence among nations. Governments are inextricably tied to each other, thus requiring constant and dynamic interaction to resolve conflicts based on a continuing process of consultation, negotiation and compromise at both domestic and international levels.[6]

GATT and the International Trade System

The General Agreement on Tariffs and Trade emerged from early postwar negotiations aimed at setting up the broader, more ambitious Havana Charter for an International Trade Organization. The ITO was to be part of a broad new order for international cooperation within a United Nations framework. The United States took the lead in launching and designing the GATT system. Canada gave strong support and has continued to play a leading role in the GATT. The earlier U.S. dominance in the GATT is now shared with the European Community (EC) and Japan. As a consequence, the role and influence of Canada and other middle-sized countries may have been somewhat diminished, but is still relatively strong.

The GATT, together with its series of subsidiary and related agreements, constitutes the principal instrument governing the conduct of world trade. All of Canada's important trading partners, with the

exception of the Soviet Union, China, Mexico, Venezuela and most other OPEC countries, are contracting parties to the GATT. The main features of the GATT have been described elsewhere but can be briefly summarized here.[7]

As a *treaty*, the GATT consists of a code of rules now formally subscribed to by 92 countries and applied on a de facto basis by a further 30 countries. Together, these countries account for about four-fifths of world trade. As an *institution*, the GATT provides a forum where its members can discuss trade problems and negotiate progressive reductions in barriers to trade, as well as oversee application of the rules embodied in the treaty, improve and extend these rules, and provide facilities for resolving disputes.

The GATT is founded on several key concepts. First, tariffs should be the principal instrument of protection at the border. The tariff is a barrier which is highly visible and readily lends itself to negotiation. Second, the benefits of negotiations between any two parties to the GATT would automatically be extended to other parties (the most-favoured-nation principle). This benefit is of particular importance to the smaller countries in the trade system, which often lack sufficient leverage to negotiate the sort of concessions they are seeking. To a large extent, the remainder of the GATT provisions were designed to ensure the integrity of members' tariff concessions and thus guard against the possibility that countries would develop barriers to trade other than those recognized by the GATT and operating within agreed rules.

The GATT includes provisions to suspend obligations temporarily for balance-of-payment reasons and in circumstances where serious injury to domestic producers is either caused or threatened by increased quantities of imports. It is also possible to renegotiate previously bound tariff rates in circumstances where increased protection is required. These actions require review by other contracting parties in the case of balance-of-payments measures, as well as consultations and usually demands for compensation from the principally affected countries in the case of safeguard measures and the renegotiation of specific tariff bindings. Procedures exist whereby a contracting party may, in exceptional circumstances, seek a waiver or derogation from specific GATT obligations. This requires approval by a two-thirds majority in a vote among the contracting parties. An important example is the U.S. waiver for import restrictions imposed under Section 22 of its Agricultural Adjustment Act.

The GATT recognizes that measures other than tariffs can, in practice, represent substantial barriers to trade. Various general rules were therefore incorporated into the GATT which cover such practices as subsidies and countervailing duties, dumping, customs valuation, customs formalities and fees, marks of origin, quantitative restrictions, state trading, national security and government procurement exceptions. As tariffs

have been reduced, the impact of non-tariff barriers to trade has become more evident, and efforts to bring them under greater international scrutiny and discipline have increased. The Tokyo Round resulted in a number of new agreements which supplement the GATT and provide added precision to international rules in their areas. These include agreements on technical barriers to trade, on subsidies, and on import licensing procedures and a revised agreement on anti-dumping procedures.

The GATT is the principal trade agreement between Canada and its major trading partners and has provided the framework within which Canada has conducted almost all of its postwar trade negotiations. The GATT's most-favoured-nation and national treatment provisions have been particularly important in establishing the terms and conditions of access to foreign markets currently enjoyed by Canadian producers. The GATT dispute settlement system, which helps to neutralize the disparities in power between different countries, provides the mechanism within which Canada can seek to resolve trade disputes with its partners.

The multilateral trading system embodied in the GATT has created an environment within which Canada has been able to find important allies in seeking its key objectives regarding access to foreign markets. For instance, during the Tokyo Round of Multilateral Trade Negotiations, Canada obtained U.S. agreement to introduce a meaningful injury test before levying countervailing duties. For Canada alone to have negotiated this with the United States would probably have been considerably more costly than it was. The objective was more easily obtained because a number of other countries, including the members of the European Community, were seeking the same objectives and were prepared to deploy their leverage in support of them. Similarly, the integrity of the concessions negotiated in the GATT is enhanced by the fact that there is almost always more than one important country which is interested in the maintenance of that concession by another party. Thus, before altering the concession, or impairing its benefit, a party in the GATT must consider the reaction, not only of one country with which it may have initially negotiated the concession, but also of a number of other contracting parties which have a significant interest in the trade of the product in question.

The GATT furthermore provides a clear description of what the international obligations of countries are in the trade field and the mechanism, through the dispute settlement procedures, of determining whether or not a particular action by a country is in conformity with its obligations. For example, Canada decided in 1983 that it would be preferable to have the GATT examine whether or not certain practices under the Foreign Investment Review Act were consistent with its GATT obligations, rather than continue to discuss the matter bilaterally with

the United States. A GATT panel subsequently concluded that one of three practices in dispute (export performance requirements) was inconsistent with this country's GATT obligations, and as a result the Canadian government directed the Foreign Investment Review Agency (FIRA) to change its procedures and make its practices consistent.

In addition to the GATT proper and the ancillary agreements noted above, a number of other agreements have been negotiated within the GATT system to manage trade in a particular sector, or amplify or modify existing rules.

The Aircraft Agreement negotiated in the Tokyo Round, which provides for duty-free treatment on all civil aircraft and aircraft parts including flight simulators, has proved to be of particular benefit to Canada. The negotiation of this agreement showed how a traditional tariff negotiation could be modified to deal with products in a particular sector of international trade. In future, this process may be applied in one form or another to other sectors of international trade.

The Agreement on Government Procurement extended the discipline of the GATT system into an area of international trade which previously had not been the subject of extensive international rules. This agreement, while modest in coverage, does provide a sound basis for bringing other areas of government procurement of particular interest to Canadian exporters under international discipline, such as telecommunications equipment, heavy electrical generating equipment and surface transportation equipment.

The Arrangement Regarding Bovine Meat and the International Dairy Arrangement were developed to improve the management of trade in these two sectors. They provide for the sharing of information and regular consultation. The Dairy Arrangement also includes provisions for price and market discipline, and thus functions in a manner analogous to a commodity agreement. Canada is not a member of the Dairy Arrangement, but acts as an observer at regular meetings of the International Dairy Council.

The 1981 Arrangement Regarding International Trade in Textiles, the seventh in a series of special arrangements for the textile sector, is a derogation from GATT Article XIX safeguard procedures.

The Customs Cooperation Council (CCC), while not formally attached to the GATT, is an integral part of the GATT system. It provides a forum for the gradual standardization and simplification of customs procedures. It administers the Kyoto Convention and its many annexes which provide a detailed construction of international rules governing customs procedures. The CCC has also been preparing the Harmonized System of Tariff Nomenclature which, when adopted by most GATT members, will simplify tariff schedules and provide an improved basis for comparison of tariff levels and trade statistics. Finally, under the Customs Valuation Agreement of the GATT, a Technical Committee on

Customs Valuation was established under the auspices of the CCC with a view to fostering uniformity of interpretation and application of the Valuation Agreement.

While the GATT rules and its other functions are narrower than those proposed for the Havana Charter/ITO system, the GATT has functioned relatively effectively as the central element in a wider framework for cooperation in trade policy areas. Other elements in the multilateral system have evolved to fill some of the gaps in the ITO system, or in response to changing circumstances. These elements, considered further below, include the UN Conference on Trade and Development (UNCTAD), OECD, Summit meetings and the more recent quadrilateral meetings of trade ministers from the United States, the European Community, Japan and Canada.

The GATT system has been under considerable stress in recent years as it has sought to cope with such developments as growing membership, regional integration, the new protectionism, structural adjustment and differentiated treatment for developing countries. At times, pessimists seemed to question the capacity of the system to respond and adjust to changing circumstances. While recession-inspired measures and others have to some extent undermined the credibility of the GATT, there is no need to question the basic soundness of the system. The system can be no better than the collective will of its members. At the same time, an active and forward-looking work program anticipating future negotiations is essential if governments are to inspire the necessary confidence capable of leading to sustained, stable economic growth. Such a work program is likely to lead to further evolution of the rights and obligations contained in the system. Areas for consideration in this context include:

- a continued search for improvements in the safeguard system, including bringing under multilateral discipline those safeguard measures taken outside the GATT (e.g., the so-called voluntary export arrangements and orderly marketing arrangements);
- a further strengthening of the dispute settlement procedures which could, for example, serve to mitigate the effects of power disparities between Canada and its major trading partners;
- an expansion of the Government Procurement Agreement to include sectors such as telecommunications, power generation and transmission, and surface transportation equipment;
- an expansion of the product coverage of the Civil Aircraft Agreement and measures to deal with concessional export financing practices in this sector;
- a strengthening of the Subsidies and Countervailing Duties Agreement to constrain, for example, the use of concessional export financing as a competitive policy instrument;
- a continued search for improvements in international rules governing

agricultural trade, particularly those relating to direct and indirect export assistance;
- an opportunity to improve foreign market access for resource-based products, particularly fisheries, non-ferrous metals and forest products;
- the gradual acceptance by the more advanced developing countries of international obligations commensurate with their stages of economic development;
- an examination of the impact of barter trade;
- consideration of an international framework for trade in services;
- the introduction of an international system of tariff nomenclature and commodity classification which takes account of Canada's particular needs;
- consideration of the practices of multinational enterprises in the context of trade-related investment issues; and
- examination of the particular problems that may exist in trade in advanced-technology products.

The last round of multilateral trade negotiations was concluded in April 1979. Since then, stress on the system has increased as governments have found it increasingly difficult to resist protectionist pressures. The Tokyo Round had assisted in providing a focus for resisting protectionism, which disappeared on its conclusion. In November 1982, in an effort to stimulate greater commitment to the GATT system, the contracting parties met at the ministerial level to symbolize their political commitment. Both the preparatory process and the meeting itself, however, failed to live up to expectations. The laborious process of negotiating a GATT work program demonstrated how far the consensus favouring liberalized trade had eroded and how difficult it was to gain consensus among 88 countries. While ministers adopted an ambitious work program and issued a political reaffirmation of their commitment to the GATT system, both documents were no more than a long, standard shopping list and standard rhetoric.

Since the Ministerial meeting, efforts have been directed at smaller gatherings to build consensus more slowly in the areas for priority attention. There are now suggestions that there be another Ministerial meeting in 1986 and that such a meeting launch a new round of multilateral trade negotiations. Prime Minister Nakasone of Japan sought support for such an approach and gained the endorsement of President Reagan and Prime Minister Trudeau in 1983. It has since been pursued at various Summit meetings and within the GATT itself. Officials are beginning to consider issues and mandates. The GATT director general established a group of independent experts which recommended negotiations. While still too early to judge with precision, there appears to be a move

toward negotiations by the end of the decade. Should new negotiations materialize, there would be significant opportunities for Canada to seek improved access for Canadian exports and to participate in the elaboration of new rules.

The IMF and the International Monetary System

Just as the GATT is the backbone of the international trade system, so the International Monetary Fund (IMF) is the central element in the international monetary system. This system also includes the International Bank for Reconstruction and Development (IBRD or World Bank), the International Finance Corporation (IFC), the International Development Association (IDA), the regional banks, and the Bank for International Settlements (BIS). With the exception of the regional banks, these institutions are all broadly based in their membership, and all involve formal rights and obligations in the monetary field. The activities of these organizations are in turn supplemented by less formal arrangements or those involving fewer countries such as, for example, the macroeconomic discussions in the OECD, the cooperation inherent in the European monetary system, discussions at Economic Summits, and the considerations of the Group of Basel regarding interventions on the foreign exchange market.

The IMF, together with the IBRD, was established at the 1944 Bretton Woods Conference and represented the first tangible evidence of the system of multilateral cooperation which was to play such a large role in postwar international affairs. The IMF provided a new set of rules about exchange rates and exchange restrictions, aimed at overcoming the chaotic and restrictive competition of the 1930s, and a mechanism to provide financial support for balance-of-payments adjustments. Like the GATT, the IMF established general principles relating to such matters as convertibility, stable exchange rates, non-discrimination and exchange restrictions. It then provided for exceptions to the general rule, but within agreed terms and under multilateral supervision.

Central to the IMF in 1944 was a belief in stable or fixed exchange rates and the progressive elimination of restrictions covering current account transactions. The IMF also provided a recognized centre of expertise and a forum for consultation and collaboration regarding the international impact of domestic monetary and exchange decisions. All participants agreed to avoid unilateral actions which would affect others and instead to adopt a multilateral, cooperative approach. Its operations were to be financed by subscriptions, or quotas, paid by member countries. These quotas were to reflect generally the relative importance of their respective economies in the world economy. Quotas also established the size of a member's basic contribution, its entitlement to borrow and its voting power.

By the early 1970s, it had become evident that the par value system established at Bretton Woods in 1944 was not conducive to the promotion of necessary adjustments. As a result, floating exchange rates were adopted by major countries in March 1973 after repeated crises on the exchange markets. The "new" IMF now permits both floating and pegged rates and has abandoned the search for stable but adjustable par values. The experience of 1973–74 and of the past decade has demonstrated, however, that neither system is perfect and each has its problems. The flexible exchange rate system has, on the whole, worked well although a number of unsettling influences have from time to time led to bouts of exchange rate instability caused mainly by the existence of wide divergencies in inflation rates, large capital flows between countries and uncertainties over policies. Floating, however, has permitted smoother adjustment and less reliance on restrictive measures, thereby helping to maintain a liberal trade and financial environment.

The monetary crisis experienced in the late 1960s and early 1970s and the gradual resolution of that crisis demonstrated that the IMF is a reasonably flexible instrument capable of adjustment to changing circumstances. On this point, Guillaume Guindey noted in 1980:

> As many of its [the international monetary system's] aspects result from the way it is applied and from the rules followed by monetary authorities rather than from treaties ratified by legislative bodies, it is not very difficult to adjust the system (or some of its parts at least) provided the monetary authorities are willing.[8]

In the 1980s, generalized floating probably will continue to dominate exchange rate arrangements if divergent economic performance continues, and the old controversy between those favouring a freer float and those who advocate more managed rates will therefore continue. Under these circumstances, the exchange rate role of the IMF is not as clear-cut, nor its performance as effective, as it was under the par value system. Nevertheless, the scope for Fund surveillance has been significantly broadened since the 1978 amendment of the Articles of Agreement to include consideration not only of exchange rate policies but also of the appropriateness of other related policies. There is room to strengthen the Fund's surveillance activity so as to focus on the underlying macroeconomic causes of balance-of-payments disequilibria and currency instability, in particular in the larger industrial countries. It is more difficult for the Fund to discharge this broad surveillance responsibility with respect to surplus countries, or to those with easy access to capital markets, than it is in the case of deficit countries seeking Fund financing. Members remain reluctant to surrender their sovereignty to the Fund. The active cooperation of its members in surveillance activity is thus important.

In recent years, the IMF has responded to continuing external diffi-

culties faced by many of its developing country members by placing more emphasis on assisting them to restore a viable balance of payments as quickly as feasible through the implementation of sound stabilization programs. Indeed, in recent years, the Fund's activities have increasingly focussed on the problems of developing countries. The external payments and indebtedness problems of many of the non-oil developing countries have been a source of particular concern and attention. In late 1982 and 1983, the IMF was instrumental in managing the problem of the crisis that was feared if the debts incurred by any of the major lesser developed countries (LDCs) had been repudiated by them. A major infusion of new funds helped it to instil further confidence. It is probable that the most important challenge to be faced by the Fund in the late 1980s will be how to promote the necessary adjustments to a difficult macroeconomic environment.

In line with its general objectives, the IMF seeks to promote stability and order in exchange rates, to foster a multilateral system of settlements for current transactions between members, and to eliminate exchange restrictions that hinder world trade by means of its surveillance and financing functions. IMF staff hold regular consultations with member countries and prepare assessments for discussion by the Executive Board. Accordingly, the IMF provides short- and medium-term financial assistance to members faced with balance-of-payments difficulties, regardless of their degree of economic development, in order to enable them to correct the imbalances in their external accounts with a minimum of disruption to the international monetary system. It also provides, upon request, economic and technical assistance to members, in particular to lesser developed countries.

The major tool of the IMF is the provision of loans (based on a member's quota) under varying conditions from its pool of currencies contributed by members. These now amount to approximately US$112 billion (most of which are *not* usable at any one time because they belong to countries with balance-of-payments deficits or low levels of official international reserves). These resources can be supplemented by borrowing by the IMF: the General Arrangement to Borrow, under which funds are available principally to the ten participating industrial countries, provides some US$20 billion but can under certain circumstances be provided to others; a US$6 billion loan was recently also made available by Saudi Arabia ($3 billion) and 14 industrialized countries.

Like the GATT, the IMF relies largely on a system of self-help or self-initiation. The Fund normally does not dictate terms to its members, but rather provides a forum for consultation, collaboration and expert advice. It does not exist independently of its members as a sort of supranational world organization. The IMF has not yet come to play a significant role in fostering greater economic policy coordination among industrialized countries. However, the managing director does partici-

pate in meetings of the G-5, the group of five major industrialized countries whose finance ministers consult regularly on broad policy matters.

IMF members are free to do as they choose, but in the knowledge that their actions may result in counter-actions by others and an inability to gain the support of the Fund's resources. This approach is based on the concept that while financial and monetary decisions are an important determinant of national sovereignty, they affect the interests of others and thus should transcend the will of individual governments. By being prepared to give up some freedom, members gain the ability to influence the behaviour of others.

The IMF's role as a financial institution involves a balance between financial assistance and the implementation of adjustment measures to resolve the cause of the balance-of-payments problems. Views of that role in the 1980s range from those who believe that the IMF should be essentially a short-term lender with a very high degree of emphasis given to adjustment as opposed to financing, to those who believe that the IMF should be a lender of last resort and instead play a larger role as a financial intermediary providing large amounts of financial assistance with a much more relaxed attitude toward adjustment. In this regard, it should also be noted that one of the strengths of the IMF lies not so much in what it does or what it obligates members to do, but in the fact that because it exists, it exerts considerable influence on its members' monetary, exchange-rate and other macroeconomic policies. In some sense, its contribution would become more apparent should it cease to exist.

Since the inception of the IMF, Canada has been a strong supporter of its role as a financial institution. Successive Canadian governments have maintained that, through an appropriate blend of financing and adjustment, the IMF can play a unique role in promoting stability in the international monetary system. Canada's position has therefore been midway between the two poles mentioned above. Although developments in our own balance of payments have resulted in minimum use of the Canadian dollar in Fund transactions in recent years, Canada traditionally has been a net creditor in the Fund. Canada required a US$300 million loan from the Fund during the exchange crisis of 1962, a crisis which brought to an end Canada's long experiment with a floating rate. Canada had been given an exemption to float its dollar largely because such a move was not seen as having broad repercussions. In supporting the IMF financial operations, Canada has promoted the creation and adaptation of lending facilities in the light of developments which, while as helpful as possible to individual members in need of assistance, were compatible with the Fund's fundamental objectives, particularly in regard to the promotion of balance-of-payments equilibrium in an open trade and financial system.[9]

The IBRD, or World Bank, originally established to help finance

postwar reconstruction, has evolved into an institution largely dedicated to helping finance economic development in developing countries. Its efforts are now supplemented by the activities of the International Finance Organization (IFC), founded as an affiliate of the IBRD in 1956 under separate Articles of Agreement, and of the International Development Association (IDA), comprising most of the major donor countries. The IBRD and IDA have, as their main function, the extension of loans and credits to the developing countries in order to enable them to finance projects which contribute to their economic development. The Bank obtains most of its funds by selling bonds in private capital markets. The IDA's resources come mainly from governments in the form of interest-free advances, enabling it to make loans on soft terms. The IFC supplements the activities of the Bank and IDA by making and encouraging investments on commercial terms in productive private enterprises in developing member countries. All these institutions are closely linked. Membership in the IMF is a prerequisite for membership in the World Bank, and membership in the Bank a prerequisite for membership in the IDA and the IFC.

The World Bank seeks to supplement the activities of the IMF by acquiring a comprehensive view of the position and prospects of developing countries' economies and their development requirements. Its role is largely long-term and focusses on development, rather than having the short-term, balance-of-payments focus of the Fund. The Bank identifies economic sectors and projects which should be given high priority, and informs judgments on questions relevant to a borrowing country's economic growth, economic policies and its eligibility of World Bank or IDA financing.

By giving continuous attention to the economic situation of developing member countries, the World Bank also seeks to help such countries make more effective use of all resources at their disposal, both domestic and foreign. It does so by providing assistance in formulating development policies, establishing development organizations, drawing up investment programs for specific sectors and regions, identifying and preparing projects for financing, and encouraging the coordination of development assistance from bilateral and multilateral agencies. In recent years, the World Bank has paid particular attention to the problem of greater equity in the distribution of benefits from development. This has resulted in increased emphasis on projects which affect the living conditions of the poorest groups in the developing world, e.g., agriculture, population planning, and urban housing. In addition, the World Bank has launched a major program for energy development, particularly in the oil-importing developing countries. The program, which includes exploration, could represent up to ten percent of the lending programs of the Bank and IDA by 1987.

In addition, mention should be made of the four regional banks: the

African Development Bank, the Inter-American Bank, the Caribbean Development Bank, and the Asian Development Bank. Canada participates in the work of all four. Each exists to promote and finance economic development in their respective regions. Their resources finance individual projects and act as seed money for major projects. Their activities supplement the work of the more broadly based financial institutions.

The United Nations System

Technically, the IMF and its affiliated financial institutions are part of the United Nations system, and indeed one of the major strengths of the UN system lies in the contributions of the various specialized organizations. The International Trade Organization was also to have been a specialized agency of the UN but its proxy, the GATT, as a multilateral contract, enjoys an ambiguous status.[10] As a practical matter, however, these two central elements of the multilateral trade and payments system operate wholly independently of the UN. Their relationship is governed by agreements between the UN and the IMF and GATT respectively. A similar status is enjoyed by some dozen other specialized agencies whose activities are confined to particular areas of international activity, largely of a technical nature. Those of direct relevance to Canada's economic rights and obligations are the International Labour Organization (ILO), the Food and Agriculture Organization (FAO) and its World Food Program (WFP), the International Civil Aviation Organization (ICAO), the Universal Postal Union (UPU), the International Telecommunications Union (ITU), the Inter-Governmental Maritime Consultative Organization (IMCO), the International Atomic Energy Agency (IAEA), the United Nations Industrial Development Organization (UNIDO), and the World Intellectual Property Organization (WIPO).

A number of these technical organizations have a long history and indeed served as models of successful multilateral cooperation to the architects of the postwar multilateral trade and payments system. The UPU, for example, traces its origin to the 1874 Berne Treaty and the ITU to the International Telegraph Union founded in Paris in 1865. They testify to the long-held view that, where possible, nations should collaborate and find common solutions to similar problems, especially in technical areas where individualism could be expensive and impede the international movement of goods, people, ideas, capital and services. Much of the work of these agencies is coordinated by the UN Economic and Social Council (ECOSOC) which meets annually to review their reports and make recommendations to them in a manner consistent with the autonomous status of these organizations. The nature of the activities of the specialized agencies was well summed up by the Canadian representative to ECOSOC's first session when he said:

> We represent, one might say, the positive side of the work of the Organization. Our task is not so much to prevent as to do, not so much to prevent the undesirable as to accomplish the good. . . .[11]

The work of these various organizations is carried out in a number of ways and illustrates the nature of the rights and obligations they involve. Most of them hold annual or less frequent meetings which examine broad policy matters and in which all member governments participate. The actual work of the organization takes place in much more frequent meetings of technical sub-groups and by the secretariats, both overseen by a governing board elected by the general assembly. The articles of agreement or convention establishing each organization set out broad statements of purpose and principle which are translated, by the ongoing work of the organization, into specific decisions, conventions, codes and standards. Most decisions are taken by consensus after laborious technical preparation and usually represent a political commitment by member governments to conduct their activities in the agency's area of competence in a particular manner. Should any proposal enjoying broad support not be wholly acceptable to any member government, there is often provision for a reservation or opting out. More onerous obligations may require more formal treaty procedures. These could include, for example, a convention which is recommended by resolution of the assembly of the whole organization, but which does not enter into force until it has been formally accepted by a certain number of members.

In regard to the activities of all of these organizations, it is worth noting that member governments pursue the policies and programs they find desirable in response to domestic political requirements. Normally, however, these policies and programs are designed and implemented by people knowledgeable of the international rights and obligations which exist in that sphere of activity and thus are largely consistent with them. If national needs dictate an approach inconsistent with existing rights and obligations, ways can usually be found to resolve the problem. As a practical matter, however, such a situation rarely arises. The specialized agencies have tended to have their greatest impact in those areas where international cooperation is clearly in accordance with the national interests of most of the member states. Less progress has been made in those areas where issues related to international conflict have intervened or where domestic political systems or power groups have apparently felt themselves threatened by proposed programs or decisions. For all, however, the habit of intergovernmental consultation, cooperation and collaboration has been beneficial to the interests of member governments.

For purposes of illustration, a description of the activities of two of these agencies should illustrate generally the nature of Canada's rights and obligations in the diverse areas of competence of the various specialized agencies.

The International Civil Aviation Organization, founded by the 1944 Chicago Convention, exists to study problems of international civil aviation, to establish international standards and regulations for civil aviation, and to foster the development and planning of international air transport. Specifically, ICAO promotes safety through standardization, training and regulation, provides statistics, works to reduce red tape at international airports, codifies international air law and extends technical assistance to developing countries. The rights and obligations it entails are to be found in the decisions of its assembly, council and technical commissions and the various technical annexes to the Chicago Convention.

Canada's position as a major trading nation, its geographical situation astride important international air routes, and early recognition of the value of aircraft in developing remote parts of the country and in providing improved communications between the various regions combined to give it an early interest in international civil aviation activities. Canada made a large contribution to the Chicago Convention and, in recognition, ICAO's headquarters were placed in Montreal.

The Food and Agriculture Organization of the United Nations was founded in Quebec City in 1945. Its purposes are:

> To raise levels of nutrition and standards of living; to secure improvements in the efficiency of the production and distribution of all food and agricultural products from farms, forests and fisheries; to better the conditions of country dwellers; and, by these means, to contribute to an expanding world economy.[12]

In carrying out these purposes, the FAO promotes the development of the basic soil and water resources of countries and encourages the establishment of a stable international market for their commodities. Among many other activities, it promotes the global exchange of new types of plants; spreads advanced techniques across the world; combats epidemics of animal diseases, such as rinderpest, in many countries; promotes the development and utilization of the resources of the sea; and provides technical assistance in such fields as nutrition and food management, soil erosion control, reforestation, irrigation engineering, control of infestation of stored food, and production of fertilizers.

With a view to alleviating the perennial problem of hunger, the UN and the FAO jointly established the World Food Program (WFP) in 1963. Its resources are used for food development projects, emergency aid and assistance to the disadvantaged. Canada is the largest contributor to the Program.

A further important activity of the FAO, in conjunction with the WHO, is the work of the Codex Alimentarius Commission which gradually is establishing world food standards to protect the health of consumers and ensure fair practices in food trade.

The Economic Activities of the United Nations

While most of the major multilateral rights and obligations in the economic area are to be found in the activities of the specialized agencies, the UN and its various subsidiary bodies and commissions also make an important direct contribution to order and stability in international economic relations.[13] It is not necessary here to restate these rights and obligations in detail. Many of them are of a political nature to supplement the technical work of the specialized agencies, and they frequently find expression in the activities of the UN devoted to helping the developing nations improve their standards of living. Indeed, it has been noted that, since about 1960, the United Nations has changed from an organization dedicated to peace and security to one engaged in a gigantic effort to redistribute from the rich to the poor not only food and other essentials of life but also resources of capital and technology that can offer prospects of a brighter future for the masses of the Third World. These suborgans of the UN include the UN Development Program (UNDP) and the five regional economic commissions, all of which are further subdivided into various commissions and committees devoted to particular activities. Canada is a member of the Economic Commission for Europe and the Economic Commission for Latin America and participates in some of the activities of the Economic Commissions for Africa and Western Asia, and the Economic and Social Commission for Asia and the Pacific.

Within the United Nations proper, the most important organization in terms of Canada's commercial policy is the United Nations Conference on Trade and Development. UNCTAD emerged in the early 1960s as a response to the increasing frustration on the part of developing countries with the pace of their development and the limited contribution made by the GATT and other organizations. The Conference proper meets every four years, with subsidiary bodies functioning continuously in the interim, supported by a large international secretariat headquartered in Geneva. UNCTAD provides a powerful stimulus to the consideration of trade and economic issues of primary concern to developing countries. Furthermore, it provides a useful universal consultative forum to consider these issues and develop a consensus where possible. As such, it has contributed to growing international awareness of the problems facing these countries and to identifying solutions to these problems. From Canada's perspective, however, UNCTAD promotes concepts of a world trade order at odds in many instances with that of the GATT. UNCTAD favours an order based on preferences and discrimination in favour of developing countries; GATT is based on the principles of non-discrimination, gradual liberalization of trade barriers, and a common body of international rules and procedures.

Specific commercial and economic policy issues pursued in UNCTAD

include commodity trade, international financial and monetary issues, competition policy, transfer of technology, control of multinationals, development assistance, and maritime policy. For some of these, especially commodities, UNCTAD offers the only universal forum where these issues are considered in any degree of depth. Unfortunately, there is often conflict within UNCTAD. Only on rare occasions are there clear instances where the commercial policy interests of developed countries match those of developing countries, so that the situation can then be furthered by UNCTAD discussion. The strength of UNCTAD for most of its members becomes its weakness for most of the industrialized countries, including Canada: its highly politicized and confrontational nature. Developed countries prefer that monetary and trade policy issues of real concern to them be handled elsewhere. Their participation is thus largely dictated by political rather than economic or commercial considerations.

During the 1960s and early 1970s, UNCTAD's most notable achievement lay in generating and promoting support for a Generalized System of Preferences. As a result, all industrialized countries now have schemes in their tariff policies which provide for varying margins of preference for imports from developing countries, and this has expanded their ability to compete in industrialized markets.

The most important set of issues considered in UNCTAD revolves around trade in primary commodities. UNCTAD coordinates all UN activities related to commodity trade, prepares in-depth studies, provides for technical and preparatory meetings aimed at the possible establishment of intergovernmental commodity organizations, and calls international conferences to negotiate international commodity agreements or arrangements. A number of these now exist, including formal agreements with economic provisions for tin, cocoa, coffee, natural rubber and sugar. Other arrangements providing rights and obligations which stop short of market intervention provisions exist for a range of other commodities including lead and zinc, jute, tropical timber, and tungsten. Periodic intergovernmental meetings are held on these arrangements, as well as on commodities for which no formal arrangements exist.

Multilateral Cooperation Outside the UN System

While the UN and its various subsidiary and affiliated organizations account for the bulk of multilateral cooperation, a number of other institutional channels have developed over the years to provide opportunities for consultation and collaboration on a less than universal basis including, on the economic front and of relevance to Canada, the OECD, the Commonwealth, the Economic Summits and the Quadrilateral meetings. These organizations or forums provide further proof of the growing

multilateralization of international activity and the desire to institutionalize and manage economic interdependence.

The Organization for Economic Cooperation and Development enjoys a key position in the world economic and trade system. It evolved out of the Organization for European Economic Cooperation, which was established to manage Marshall Plan aid for the reconstruction of Europe, and attained its current format in 1960. The OECD contributes significantly to cooperative efforts across a broad range of economic, social and scientific endeavours. Its 24 members comprise the western European democracies, the Commission of the European Communities, Turkey, Yugoslavia (as an associate member), Japan, Australia, New Zealand, the United States, and Canada. While representing only 20 percent of the world's population, this small "club" of the world's most highly developed and richer countries accounts for 60 percent of total industrial production and 70 percent of total world trade.

The OECD has a number of features which distinguish it from other international economic bodies. A primary distinguishing feature from a trade perspective is that it is basically a consultative forum. With limited exceptions, there are few binding elements in the Organization; this contrasts sharply with the contractual nature of the GATT and IMF. Furthermore, it provides a unique multidisciplinary approach to analyzing major international issues. The OECD is composed of directorates dealing with financial and macroeconomic issues, trade, development assistance, social and manpower policies, science and technology, agriculture, and energy. This range of activities enables the Organization to bring a variety of different perspectives to bear on major international issues. Finally, from a Canadian perspective, its value lies in that it provides a restricted forum among a group of like-minded countries with similar problems and approaches.

The mandate of the OECD is to promote policies which are designed to achieve the highest sustainable economic growth and employment and a rising standard of living in member countries, while maintaining financial stability; to contribute to sound economic expansion in member as well as non-member countries; and to contribute to expansion of world trade on a multilateral, nondiscriminatory basis in accordance with international obligations as embodied in the GATT. These objectives are achieved through regular consultations and exchanges of information, special studies, cooperation and, when appropriate, coordinated approaches or strategies. There are numerous specialized committees and working groups in the Organization.

The OECD's range of activities is illustrative of its contribution to the effective management of the multilateral trading order. The OECD periodically reviews issues in East-West and North-South trade and helps its members to develop common approaches. Its comparative

analyses of members' industrial policies and its studies of difficulties in the adjustment process assist member governments in developing policies responsive to rapidly changing competitive circumstances. The OECD has been actively involved in investment issues and has developed a number of common policy positions. Similarly, it has evolved guidelines regarding the practices of multinational enterprises and restrictive business practices. The establishment of the Steel Committee a few years ago was instrumental in reducing conflict in that sector. The OECD's work in the energy sector evolved into the establishment of the International Energy Agency.

One important set of rules managed by the OECD is the Gentlemen's Agreement or Consensus covering the provision of officially supported export credits. Nearly all OECD member governments provide some degree of support to the export of capital goods and services by means of medium- to long-term export credit facilities. The systems adopted by different countries vary widely in their institutional structure and in the extent of official intervention in the availability of funds and levels of domestic interest rates. In 1976, in an effort to curb destructive competition among OECD members through export-credit terms, the seven summit countries reached a consensus on what was and what was not permissible. Since 1978, all OECD members except Iceland and Turkey have participated in the Arrangement on Guidelines for Officially Supported Export Credits. The guidelines are periodically reviewed in the light of market developments and members meet frequently to exchange information and views. The Arrangement has gone some way toward curbing the destructive type of competition based on export credit.

The Commonwealth provides yet another model of cooperation. Its members are all former British colonies which over the years have found that they hold a wide range of interests in common and which have found consultation and cooperation beneficial. It comprises a diverse group of countries at various stages of economic development. In many ways, the Commonwealth represents a microcosm of the United Nations, preoccupied with many of the same issues. Yet, because the members view their discussions as being "in the family," there is a notable absence of discord and strife. The relative harmony of the Commonwealth, however, lies also in the low level of obligation its decisions imply. They usually constitute statements of broad principle and purpose. The strength of the Commonwealth lies in its ability to generate free-wheeling debate and useful background studies on important issues of the day.

Economic summits, eleven of which have now been held annually since the first one at Rambouillet in 1975, illustrate the complexity which interdependence and multilateralism have introduced into international relations, as well as the dispersal of economic power among a larger group of countries. The United States clearly held the preponderance of

power in the Western world in the 1940s and 1950s. This gradually came to be shared, and the need for coordination among the major economic powers became steadily more apparent.

While originally envisaged as a single event, summits have developed a semi-permanent character and will probably remain part of the scene in the 1980s. Summits have proved their value in the management of the international trade and payments system. Both the summits themselves and the meetings of senior officials preparatory to them have provided a useful basis for the seven major industrialized economies (as well as the Commission of the European Community) to compare notes and work toward common solutions to the major economic problems faced by these countries. Such periodic meetings have proved of significant psychological value to the Western world. Because there is no permanent secretariat and the host country assumes responsibility for organizing and preparing each session, summits have remained unique annual events where leaders and their principal economic ministers can speak their minds freely. Summits have provided the seven major industrialized countries with an opportunity to cooperate in providing economic leadership while at the same time avoiding stage-managing the affairs of the GATT, IMF and OECD.

Meetings of the trade ministers of the United States, the European Community, Japan and Canada have developed as an offshoot of economic summitry. The summits themselves usually are also attended by the foreign and finance ministers. Trade ministers have therefore found it useful to hold meetings of their own and to encourage their officials to meet among themselves to provide a forum for consultation and collaboration on major trade issues, especially in preparation for more universal multilateral meetings. These so-called Quadrilateral meetings may well become a regular feature of preparations for a new round of multilateral trade negotiations now under consideration. They also provide an opportunity for frequent bilateral consultations on the margins and thus instil harmony among the most important trading nations.

Bilateral Perspectives

Canada and its major trading partners have for almost 40 years pursued a multilateral approach to international economic relations. Canada, however, does not trade with the world; it trades with individual countries. Within the framework of multilateral rules and institutions, therefore, Canada and its trading partners pursue bilateral relationships and bilateral solutions to specific issues. The resolution of such issues is also governed by rules and formal commitments at a more specific, bilateral level. The exchange of bilateral rights and obligations either supple-

ments or amplifies multilateral rules or approaches to issues, or provides order where no multilateral order exists.

The range and extent of bilateral rights and obligations are wide, and vary for each relationship. The more extensive the relationship, the more extensive the network of formal and informal commitments, understandings and undertakings. As can be expected, the relationship with the United States is governed by the greatest number of bilateral understandings, as a response to intimately linked business and economic affairs.

It would be difficult to catalogue the full extent of bilateral rights and obligations governing Canada's relations with any one country, let alone for the more than 160 countries with which Canada has formal relations. It should prove sufficient for this study to describe the most important of the various kinds of bilateral economic instruments which serve to provide greater certainty and predictability in Canada's bilateral relations.

The GATT is Canada's trade agreement with all its major trading partners (including the United States, Japan and the EC) but for many of these partners, there exist supplementary bilateral trade agreements, either negotiated since the GATT came into force or predating the GATT. In addition, for those countries not members of the GATT, Canada has negotiated bilateral agreements establishing a legal framework for trade relations, often based on reciprocal most-favoured-nation treatment. The External Affairs legal bureau's list of bilateral commercial agreements in force between Canada and other countries supplementary to the GATT runs on for some 14 pages. To this list can be added numerous less formal arrangements and undertakings. To illustrate the nature of these commitments, a few examples must suffice.

The relationship with the United States is vast and complex and includes a wide range of bilateral commitments. Two bilateral agreements of particular importance are the Defence Production Sharing Arrangements dating back to the 1941 Hyde Park Declaration and the 1965 Automotive Products Trade Agreement. Both agreements provided a basis for the further rationalization and integration of these two important industries along North American lines by removing barriers to cross-border trade. The federal government is currently considering the possibilities for similar arrangements in other sectors.

Following adoption of the Third Option framework for foreign policy by the Trudeau government in the early 1970s, Canada set about finding ways to diversify its links with countries other than the United States. An early, formal manifestation of this policy were the two framework agreements signed with the European Community and Japan in 1976. While short on specific rights and obligations, these two agreements

establish objectives for the two relationships and a consultative framework for their more effective management. In effect, they placed Canada on the regular agenda of meetings in which ministers and senior officials of the EC and Japan frequently participate and which thus provide a focus for detailed ongoing work involving officials on both sides.

During the 1970s, Canada also sought bilateral consultative agreements with Middle East oil-exporting countries, many of which are not GATT members, but for which trading opportunities are considered to be many. Agreements were concluded with, for example, Iran, Iraq, Syria and Jordan but not with Saudi Arabia which was reluctant to exchange most-favoured-nation (MFN) treatment. Similar negotiations were held with Mexico and China, neither of which are GATT members, and both of which are anxious to provide for both regular consultations and the right to MFN treatment. Because these countries are not GATT members, consultations under these umbrella agreements are a regular and important feature for managing the bilateral relationship.

Even when developing and state-trading (mainly Eastern bloc) countries are members of GATT, it has been found useful to enter into a bilateral economic cooperation agreement. In addition to providing a consultative framework for the conduct of economic relations, such arrangements recognize that the private sector is not as well developed in these countries and that export success frequently requires government-to-government contacts. Such agreements typically also include an industrial cooperation element, provision for exchanges of scientific and technical information, and even a framework for the provision of aid should the developing country in question be an aid recipient. An important example of such an agreement is the one with Brazil. It provides for annual meetings of senior officials, frequent exchanges of ministerial visits, and a framework within which to review the full range of bilateral economic relations.

An important element in bilateral trade relations is the tax treatment of citizens and corporations doing business in various countries. This involves, for example, the tax treatment for a businessman resident in Toronto but earning part of his income from activities in Germany, or of a business incorporated in British Columbia but doing extensive business in Japan. Because governments all tax economic activity within their territories, sorting out who owes what to whom can be a nightmare. In order to simplify matters for their citizens, governments enter into double-tax agreements, i.e., agreements for the avoidance of double taxation. Canada now has more than 40 of these agreements, with further agreements possible. A busy schedule of negotiations keeps existing agreements up to date as tax practices evolve, and new agreements are reached as Canada's trade relations expand.

The expansion of air travel by Canadians, and the growth of Canadian air carriers, have required that Canada enter into a variety of bilateral air

agreements. These agreements fall within the general multilateral framework provided by the Chicago Convention and ICAO, and often follow the principles established in three consecutive bilateral agreements between the United States and the United Kingdom. These agreements typically provide that specified airlines can provide specified air service between the two countries. The agreement will usually indicate the frequency of service, the kind of service, the tariff schedule for the service, and the fees to be paid for in-flight and ground services. These agreements are also renegotiated frequently in order to keep abreast of evolving technology and other changing requirements.

The extensive involvement of governments in industrial research and development, especially of high-technology goods and services, has resulted in governments frequently entering into science and technology exchange agreements or industrial cooperation agreements, either separately or as part of the more comprehensive economic cooperation agreements mentioned above. Such agreements provide an efficient channel for government-to-government cooperation as well as a framework within which the private sectors of the two countries can consult, develop cooperative projects, or exchange information.

Mention was made earlier of the extensive provision by governments of officially supported export credits. In Canada, the Export Development Corporation is the federal agency which provides this credit. The EDC has negotiated a wide range of agreements and arrangements with most countries with which Canada trades so as to provide flexible means for extending credit. It is possible to provide credit to either the buyer, the seller or the buyer's government within the framework of these agreements. They can also include investment undertakings when the EDC guarantees or insures overseas investments by Canadians.

This general description of the various kinds of economic agreements Canada has negotiated is an indication of how extensive bilateral links can become. The list is far from complete. To it can be added anti-trust arrangements, trade restraint agreements (particularly for textiles and clothing), aid agreements (involving aid levels, types of aid, and linkage to the purchase of Canadian goods), nuclear energy agreements (including the provision of fuel and technology, the sale of a CANDU reactor and commitments regarding safeguards), and any other agreements which the relationship may require. What is important is to understand that these various bilateral rights and obligations formally link Canada to its various trading partners, define constraints and opportunities, and provide a framework for resolving disputes.

Canada, Interdependence and International Relations

Growing interdependence between states has meant that, for many countries, domestic priorities and objectives are becoming more closely

related to constraints and opportunities flowing from the international environment. The states which have been most successful in dealing with these complexities have been those which have defined their national interests clearly and have brought a large measure of coordination to their foreign policies. This has required a clear sense of direction and an understanding of where and by what means their interests should be pursued. It has also required the development of priorities in the use of scarce financial and human resources and, in terms of bilateral relationships, an understanding of which countries are most important to their interests. It has involved a long-term, planned, and coherent approach to the cultivation of specific relationships.

Canada's economic development and economic prosperity are central objectives of our foreign policy. These objectives are pursued both multilaterally and bilaterally. Some bilateral relationships are defined largely by security-related interests. Others are dominated by aid-related interests. But in the bilateral context, the highest importance is attached most often to the pursuit of economic interests, that relate directly to Canada's domestic economic objectives. These relationships must be underpinned by stable, planned and long-term political relationships supported by a variety of bilateral and multilateral instruments.

In the period since World War II, a great deal of effort has been expended in the definition, refining, and pursuit of Canadian interests through multilateral means and through multilateral institutions. This has been based on many factors, but above all on Canada's interest in and commitment to developing a sound international framework for the trade and payments system. Involvement in the building of multilateral institutions has been one way in which Canada has avoided becoming isolated in two-way relationships with more powerful states. It was also to encourage the increased commitment to multilateral frameworks by the United States and subsequently to attempt, in association with others, to establish counterweights to American power, that Canadian policy was marked by a strong multilateralist orientation in the postwar decades. This multilateral approach was seen as the best way of protecting and advancing Canadian interests.

These international multilateral frameworks are vital to the further pursuit of Canadian interests. But most of Canada's interests have both a multilateral and a bilateral dimension. The nature of the international system and of international transactions thus also require that Canada use bilateral instruments in pursuit of its bilateral interests. The prominence of bilateral arrangements between countries based on mutual economic interests and political ties demonstrates that a growing number of countries insist on dealing in a bilateral, government-to-government framework. These include in particular the newly industrialized countries which are becoming more important to Canadian

economic objectives. This is also a reality with which Canada has to deal. Over the years Canada has, therefore, also fostered bilateral cooperation in a manner that does not lessen the role and importance of multilateral frameworks on which Canada is so dependent. The multilateral and bilateral dimensions of Canada's international relations are thus mutually reinforcing and together constitute a formidable array of rights and obligations.

Chapter 3

Canada's Major Trading Partners

What all have still to learn is that today no nation is sufficient unto itself.
— W. L. Mackenzie King

The previous chapter described the vast and linked network of multilateral and bilateral rights and obligations that provide a framework of rules and standards of behaviour for the conduct of intergovernmental relations in today's interdependent world. Of equal influence on Canada's approach to economic development, however, are the policies and practices of its major trading partners. If these are far removed from the international rules and standards, then the rules and standards are not likely to exert much influence. Furthermore, Canada's understanding of many existing rights and obligations has been and is conditioned by international practice. Finally, while much international practice can be measured against accepted standards of behaviour, there remain developments, attitudes, and decisions on the part of major trading partners which do not fit neatly into the framework of rights and obligations described earlier but which still have an important bearing on decision making. In some areas there are no international rules, making international practice even more important. This section therefore seeks to provide a brief overview of the role of Canada's major trading partners in influencing the nature of its economic development policies.

For almost three decades following the end of World War II, Canada and its trading partners enjoyed unprecedented prosperity. Only in the past few years, when a new generation has had to confront stagnation and recession, have some of the reasons for that prosperity begun to be appreciated. In the 25 years between 1948 and 1973, world production increased at an average annual rate of about 5 percent and world trade at

an average rate of 7 percent. This unprecedented growth and prosperity was stimulated largely by internal and external liberalization of national economies within a system of multilateral rules designed to promote stable international trade and investment. Such a system, based upon specialization and the free flow of goods, services and capital, imposed restrictions on each country's ability to pursue its own particular goals and policies. At the same time, it brought significant and measurable benefits. This increased interdependence of economies needs to be recognized as a primary factor in assessing the costs and benefits flowing from the open multilateral system and in formulating national policies. Interdependence requires an understanding of the goals and policies of the major players in the system.[14]

In retrospect, the decade of the 1970s can be viewed as one in which change and pressures for change in the international political economy began to have a profound impact on the established global patterns of economic power, and on economic growth, wealth and trade. The economic measures adopted by President Nixon in August 1971, followed by the inauguration of the Tokyo Round trade negotiations in 1973; the quadrupling of oil prices in 1974 combined with the massive shift in wealth to oil-exporting countries; the commodity boom of 1974 followed by the slump of 1975; the persistent recession combined with inflation throughout the second half of the 1970s; the instability of the international monetary system and in particular the collapse of the fixed rate parity system created at Bretton Woods and its replacement by floating exchange rates; the decline of the exchange rate value of the U.S. dollar; the declining economic power of the United States in relation to Europe and Japan; and the persistent demands of the Third World for changed institutional arrangements — all combined throughout the 1970s to impose instability as well as pressures for change on global institutions and established bilateral relationships.

The years of high prosperity and growth effectively ended in 1973, and the world economy has since returned to a more normal pattern of slow growth and extended periods of uncertainty and recession. The last ten years have severely tested multilateral structures and bilateral relationships but the system has essentially held. Stresses and strains on the system undoubtedly will continue. The capacity of the individual participants to respond will largely determine whether the system will adapt and survive or stagnate and collapse.

The general economic picture that has emerged in the first half of the 1980s calls for great imagination and skill in managing international relations. The three major Western economies, the United States, the European Community and Japan are all experiencing substantial structural problems which have profound implications for the other economies. The United States has weathered the storm remarkably well, but continues to face a need for major restructuring of its basic industries.

Trade has increased greatly as a GNP component, but relative U.S. competitiveness in basic industries has waned. The 1983 U.S. recovery from the 1981–82 recession (by far the strongest in the OECD) was remarkable in that export trade played a minimal role in the recovery, with the country continuing to experience a substantial trade deficit. Japan, which for 25 years experienced phenomenal, export-led growth, is now facing a much lower rate of growth. This growth, in turn, is now much more dependent on domestic demand as Japanese exports have had to contend with a formidable array of protectionist measures in all its major markets. Europe continues to stagnate, at best experiencing marginal growth, steadily rising unemployment, and a continuing fall in competitiveness. The need for structural adjustment in Europe is immense, but the capacity of European governments to pursue forward-looking, non-protectionist policies is severely constrained. Europe's contribution to growth and systemic adjustment thus probably will continue to be hesitant.[15]

The structural problems in the major industrialized economies have been exemplified by persistent high levels of unemployment. This in turn has had a profound effect on domestic economic policies and the approach to imports, i.e., it has fuelled protectionism. Protectionism is likely to be a continuing threat in the 1980s as governments seek to introduce policies that will ease a return to non-inflationary domestic economic growth while accommodating the socio-economic problems of high unemployment.

The problems being experienced by the major economies have significant implications for the smaller economies and for world trade, particularly for LDCs. Developing countries as a group, but particularly a few countries in Latin America, have accumulated an external debt load of more than $700 billion, a load which can be reduced only by running a trade surplus. Such a surplus should be generated by increasing exports to the OECD while decreasing imports from the OECD. Such a scenario will require a reversal of current protectionism and major adjustment in OECD economies. For Canada, heavily dependent on trade, adjustment also represents a major challenge, both domestically and in its principal markets.

While U.S. dominance of the economic system waned as power came to be shared more broadly, the United States remains the most important player. This is especially true for Canada, which shares the continent, and whose two-way trade with the United States constitutes the world's largest trading relationship — now amounting to more than $150 billion annually. U.S. domestic legislation and trade policies thus continue to have a profound impact on Canada. U.S. leadership remains essential for the effective working of the system.

Europe, as we will see, has increasingly turned inward and is occupied more with regional integration than with the health of the global system.

While it can follow and support, it cannot lead. Its support, however, remains essential to the health of the system and, for better or worse, it continues to be a critical player in the system. For Canada, despite traditional political ties, Europe has become of secondary economic importance. The European market, while attractive, is crucial to the well-being of only a few Canadian industries.

Japan, the third major player in the system, does not view its position as one of leadership. Vitally interested in the multilateral system and with a proven record of exploiting the system to its benefit, it nevertheless is not prepared to forgo bilateral solutions which subvert the multilateral process. The phenomenal success of Japan in building a modern industrial machine based on penetration of world markets, however, testifies to the need to be aware of Japanese approaches. Japan's trade and industrial policies are widely regarded as either a threat or model, depending on one's perspective. For Canada, Japan has become an important, growing market for raw materials and may in future become one for manufactured goods.

The other players in the world economic system, the developing countries and the state-trading countries, while by no means homogeneous, can be conveniently considered as groups, both in terms of their role in the system, and in terms of their relationship with Canada.

The United States

Geography, combined with similar cultural and ethnic backgrounds has given rise to an interrelationship between the Canadian and U.S. economies — in terms of industry, energy, agriculture, fisheries, and also intercorporate relationships — that is immeasurably stronger than Canada's relationship with any other country or group of countries, either now or in the foreseeable future. Because of this interrelationship, the introduction of new policies in one country invariably tends to have an impact, either positive or negative, on the other which is proportionally much greater than the impact on third countries. Given the difference in size, the impact is inevitably greater on Canada. When this impact is negative, the result is often a new irritant in Canada–U.S. relations. In the same way, any change in the global role of the United States, or change in global institutions to reflect the growing economic and political power of the European Community and Japan, is bound over time to have some impact on Canada's perception of its interests in relation to the United States.

In 1984, two-way merchandise trade between Canada and the United States approached $155 billion. The United States accounted for 76 percent of Canadian exports and 72 percent of Canadian imports. On the other hand, Canada accounted for only 22 percent of U.S. exports and 20 percent of its imports. Thus, while Canada remains the United

States' largest trading partner, Canada is much the more dependent on their mutual trade. Furthermore, trade has a relatively less important place in the American economy, accounting for only 12 percent of gross national product, compared to 30 percent for Canada.

The relationship is at times subjected to stresses and strains because of irritants of various kinds in both countries. Moreover, indications are that these stresses and strains will increase if the articulation and achievement of Canada's national objectives affect U.S. interests negatively. Similarly, increasing concern in the United States about such matters as energy, raw material supply, and availability of water will lead to U.S. demands on Canada which this country may find difficult or impossible to meet for a variety of reasons. Generally speaking, however, relations are good, as expected when two neighbours have similar objectives and approaches.

The number of issues requiring attention tends to fluctuate. Some have a higher profile in Canada–U.S. trade relations than others. Automotive products, the Surface Transportation Assistance Act, energy, pipelines, border broadcasting and tax allowances, convention expenses, U.S. restrictions on groundfish and tuna imports and specialty steels, have all been highly visible as issues over recent years. Proposals for negotiations aimed at further liberalizing bilateral trade will eventually require major policy responses by both Canada and the United States. Other issues that tend to emerge regularly include the trade-distorting effects of Buy America legislation at federal and state levels; petitions for the application of U.S. countervail law against Canadian exports; import relief actions in both countries; differences in tax legislation; extraterritorial application of U.S. laws including export controls and anti-trust measures; and problems involving agricultural trade in both directions and in third-country markets.

The Trade Act of 1974 and the Trade Agreements Act of 1979 have provided U.S. industry, government and labour with a formidable array of measures to deter or retaliate against foreign policies which are deemed to affect U.S. economic interests adversely. The criteria for import relief action have been amended. The countervail law has been broadened to encompass duty-free goods. The 1979 Trade Agreements Act, which incorporated the Tokyo Round results was, however, of substantial benefit to Canada in that it introduced for all goods a requirement to find injury to U.S. producers before countervailing duties can be applied.

The United States is broadly committed to the multilateral trading system, seeing it as the best way of managing its diverse trade relations with other countries. Current U.S. trade policy is characterized by the vigorous pursuit of U.S. interests, in terms of pressing for the extension of international discipline into new areas for the benefit of U.S. traders, and in terms of exercising and testing its current international rights in

respect of a number of foreign government practices. There is a view among some observers that U.S. trade policy is too aggressive, but few doubt that it is forward-looking. At the same time, current economic conditions in the United States have led to the same sort of protectionist pressures which have arisen in other countries, in part fuelled by the effect of the overvalued dollar. A number of these pressures have manifested themselves in Congressional proposals for legislation that would have a trade-inhibiting effect or establish narrowly defined rules of reciprocity for the protection of U.S. interests. The consensus favouring trade liberalization in the United States was based originally on the secure knowledge that U.S. industry had a comparative advantage. As differences in per capita wealth among OECD countries have narrowed, and the newly industrialized countries have become more competitive, the consensus favouring continued trade liberalization has eroded considerably. This has been accentuated to some extent by growing divergence in policy approaches among OECD countries. The shift of economic power in the United States from the northeast to the south and west, farther away from the major centres of industrial production in Canada, may have a further important impact on the bilateral trading relationship. Ominous also is the ongoing industrial strategy debate in the United States. Proponents of an industrial strategy are advocating greater government planning and intervention in the economy and greater efforts to stimulate exports. A component of this debate is the widely held view that imports are a major cause of damage to U.S. industries, with the consequent demand that such imports be curbed.

While general U.S. commitment to the multilateral system is beyond doubt, it is not unreserved. The pursuit of its perceived national interest in a manner inconsistent with the international trade rules has at times undermined the credibility of the system. Four instances come to mind. International trade in agriculture has generally not been successfully brought under the GATT system, and various efforts to do so have foundered on narrow sectoral interests. First, in recent years, it has become commonplace to blame the European Common Agricultural Policy for this state of affairs. It would be more accurate, however, to trace its origins to U.S. policy dating back to the founding of the GATT and forcibly expressed in the U.S. waiver in 1955 from its GATT obligations for the Agricultural Adjustment Act. The waiver, which is reviewed annually, released the United States from a good part of its GATT obligations in regard to import restrictions on agricultural products. The United States, which is vigorously promoting the need to bring agricultural trade under firmer international rules, has to date not acted to withdraw its waiver, although the administration would probably be prepared to have someone pay for its withdrawal in a major negotiation.

Similarly, it was U.S. inability to satisfy the sectoral interests of its textile industry within the multilateral rules that led to the negotiation of

special rules for textile trade. Since 1961, the GATT-sponsored Arrangement Regarding International Trade in Textiles (Multi-Fibre Arangement or MFA) and its various predecessors have, under U.S. sponsorship, institutionalized protectionism for that sector.

The U.S. response to slipping comparative advantage to export markets in the late 1960s led to establishment of special tax rules for DISCs (Domestic International Sales Corporations). This tax practice was complained about loudly by U.S. trading partners, and finally led to an adverse GATT panel finding in 1976. The United States held up adoption by the contracting parties of the panel report until 1981.

Finally, U.S. frustration with the slow pace of adjustment in its basic industries in the face of growing imports and the consequent proliferation of voluntary export restraints and orderly marketing arrangements with some of its trading partners has been an important factor in the erosion of the international safeguards system. Thus, U.S. commitment to the multilateral system must to some extent be qualified by U.S. practice.

The role of the United States in the management and leadership of the international economy and international institutions cannot be overestimated. The negotiation of new international rules is frequently involves the internationalization of U.S. domestic legislation or ideology. Furthermore, the accepted application of these rules frequently is determined by U.S. practice. Canadian practice, for example, can become more or less protectionist depending on what is currently considered acceptable by the United States. This phenomenon is well demonstrated by the chequered history of the application of rules to trade in textiles and clothing.

The pre-eminent role of the United States in the world, and its perception of that role, has been captured rather well and wittily by Charles Ritchie. Reflecting on his posting as Canada's ambassador to Washington, he wrote:

> Even when the sun of favour is shining, there are outer limits for a foreigner to exchanges of thought with the Washington higher management. For one thing, the President never listens — or at any rate never listens to foreigners. He talks them down inexhaustibly. The phrase "consultations with allies" is apt to mean, in United States terms, briefing allies, lecturing allies, sometimes pressuring allies or sounding out allies to see if they are sound. The idea of learning anything from allies seems strange to official Washington thinking. The word comes from Washington and is home-made.[16]

Such a state of affairs may be acceptable only as long as U.S. perceptions of what is required are reasonably broad and forward-looking. Usually this is the case. Unlike trade policy in Canada, which is dictated largely by economic considerations, U.S. trade policy is based not only on economic considerations, but also on much broader strategic and

foreign policy considerations. For example, U.S. sponsorship of the GATT and subsequent tolerance of European integration were dictated less by considerations of U.S. trading interests and more by U.S. concerns about peace and security.[17]

The United States has taken an active, forward-looking approach to the trade issues of the 1980s and is using the elaboration of the multilateral trade policy agenda to demonstrate the Reagan administration's commitment to a free-trade system. Beyond implementation of the Tokyo Round agreements and concessions, the United States has called for a renewed and revitalized trading system designed to deal with new barriers as they arise. It regarded the GATT ministerial meeting in 1982 as an opportunity to establish a work program aimed at specific negotiating objectives which would enlarge and clarify international trade law and liberalize trading conditions. The relative disappointment in the GATT Ministerial has led to the search for alternative means to stimulate trade liberalization. President Reagan joined Prime Minister Nakasone of Japan in late 1983 in calling for preparations for a new round of multilateral trade negotiations. Trade Representative Brock actively promoted the U.S. trade agenda in the quadrilateral meetings of the trade ministers of Japan, the European Community, Canada and the United States. He also welcomed Canadian suggestions made in 1983 that Canada and the United States explore the possibility of bilateral, sectoral arrangements to liberalize two-way trade.[18] More broadly based bilateral economic cooperation is now being promoted by government spokesmen on both sides of the border.

U.S. officials have identified a number of specific areas where the administration is seeking new or stronger international rules, including agriculture, trade in services, the trade aspect of investment (such as trade-related performance requirements), trade in counterfeit goods, rules of origin in the context of implementing the harmonized tariff system, the greater integration of developing countries into the GATT, and trade in high-technology goods. U.S. officials are developing specific objectives in each of these areas. While most of these issues will be considered at the GATT, U.S. officials intend to focus attention in the OECD, for example, on investment-related issues. Given past U.S. leadership in establishing the international trade policy agenda for each of the past four decades, it can be expected that most if not all of these issues will figure prominently in discussions and negotiations over the next few years. At the same time, it should be remembered that the United States is pursuing its trade policy agenda and that not all U.S. objectives are shared by its trading partners.

Canada and the United States share considerable common ground in their views as to how the multilateral trading system should be managed. Government leaders in both countries have expressed strong support for the GATT and for strengthening it in the years ahead to deal with the

trade problems of the 1980s. Through positive cooperation in these areas of common endeavour, a better environment for managing the bilateral trading framework may well be established. A number of bilateral trade issues may also lend themselves to resolution either bilaterally or as part of new international negotiations. For instance, it may well be possible to remove the Buy America provisions of the Surface Transportation Assistance Act in any new GATT negotiations enlarging the coverage of the Government Procurement Agreement. Finally, Canada has suggested that both countries explore ways to improve bilateral trade flows in order to stimulate a more efficient use of investment and resources on both sides of the border. At their bilateral summit meeting in Quebec City, March 17–18, 1985, Prime Minister Mulroney and President Reagan adopted a directive on trade in goods and services which set out an ambitious program for bilateral cooperation.

The European Community

The European Community[19] is the world's largest trading entity and is a key player in international trade relations and in the GATT system. The Community has participated actively in past GATT negotiations which have resulted in a considerable lowering of the Community's external barriers to trade, particularly in industrial goods. To a large extent, however, the Community is preoccupied with regional and internal issues including its enlargement and the management of relations with its key trading partners in Europe and the Mediterranean area. The Community is less enthusiastic about any new efforts to strengthen multilateral discipline, although it is playing a part in efforts to enunciate a new work program in the GATT for the 1980s.

The European Community is Canada's second largest trading partner, accounting for about 7–8 percent of imports and exports. In 1984, two-way merchandise trade stood at $15.4 billion. As in the case of Canada–U.S. trade, Canada is more heavily dependent on its trade with the Community than is the Community on its trade with Canada. Although the EC is a bigger trading entity than the United States, it remains a decidedly less vital factor to Canadian economic well-being, the traditional ties with the United Kingdom notwithstanding. Distance and the qualitative and quantitative economic differences between cross-border and trans-oceanic trade have resulted in a different structure and smaller overall size of the trade. Finally, investment ties are relatively low and do not provide a basis for increased trade flows.

Given these factors, the Canada–EC relationship has to be regarded in a different way. The Canadian economy is, for example, tremendously vulnerable to changes in U.S. policy which affect imports, or, in a larger context, to changes in U.S. economic performance. In some particular product sectors, exports — especially to the United Kingdom — are of

major importance to individual Canadian firms and industries, but a large part of Canadian exports to Europe consist of crude materials, or products which move internationally at a relatively low level of processing to serve as inputs to European-based industries. Canadian exports to the EC market have been concentrated in items that move in bulk and require minimum investment in local sales and service efforts. This trade makes an obvious contribution to the Canadian balance of payments and is also of substantial economic importance to the sectors and regions involved (e.g., iron ore, fish, wood pulp, wheat and newsprint). At the same time, trade problems and issues tend to be minimal as most of this trade moves duty free or at very low rates, with the notable exception of trade in agricultural products. Escalating tariffs tend to impede trade in higher-valued products.

There would appear to be areas in which economic cooperation and trade between Canada and the European Community can be further developed. In a number of these instances, however, it would be necessary to seek further adjustment in the Community import regime through negotiation before the benefits of such cooperation could be fully realized. This is particularly true for potential trade in fisheries products, further-processed resource products and sophisticated end-products such as telecommunications equipment.

Agricultural policies and practices of the European Community remain of considerable concern to Canadian agricultural producers. These policies both inhibit the prospects of Canadian agricultural sales in the EC and also threaten the Canadian position in third markets, principally because of the use of agricultural export subsidies by the European Community.

The commitment of the EC to the multilateral system has to be qualified by its pursuit of European integration and the forging of special relationships with its former colonies and closest European trading partners. While the Treaty of Rome, the industrial free-trade agreements with the European Free Trade Association (EFTA) and Mediterranean countries, and the Lomé Convention have all been justified under the provisions of GATT Article XXIV, they have seriously undermined the principle of non-discrimination upon which the multilateral system is based. There is a long-standing preference for discrimination in Europe, i.e., the French approach as opposed to the non-discriminatory Anglo-American approach enshrined in the GATT. As British influence in Europe declined, the attractiveness of discrimination increased to the point where Britain is now converted to the European outlook.

The future health of the multilateral trade and payments system requires that further European integration be on a basis more consistent with the multilateral rules and that Community practice gradually con-

form more to its multilateral obligations than to its network of special relationships. EC agricultural policies and safeguard practice, for example, have contributed to the erosion of the GATT system, and EC special pleading for its various free-trade arrangements has eroded the principle of universality.[20] While the EC would argue that GATT rules were never applied in agricultural trade, and that it paid for the Common Agricultural Policy in the Kennedy and Tokyo Rounds, the EC nevertheless continues to stand as the principal obstacle to a more disciplined agricultural trade policy regime.

Canada and the Community have somewhat different views on what needs to be done to improve international trade relations, particularly through the GATT. Nevertheless, it is important that every opportunity be sought to strengthen European commitment to the GATT in those areas where we have common interests. For a number of years, for example, both the EC and Canada pressed the United States to remove the DISC tax legislation or bring it into conformity with its international obligations under the GATT. Similarly, Canada and the Community share concerns about the discriminatory procedures under United States' law for determining whether foreign goods are in violation of United States' patent provisions (Section 337 of U.S. trade law).

The EC Commission, after a cautious start, is now participating actively in efforts to elaborate an agreed international trade policy agenda. Following endorsement from the member states for a more positive approach, the EC played a constructive role in the 1982 GATT Ministerial meeting and shared in the disappointment over its meagre results. The EC has also put forward a number of general ideas for consideration, such as access to raw materials, domestic legislation having trade effects, and exchange rate problems. The Commission, however, is reluctant to put forward any specific objectives. Unlike the United States, which envisages an active, future-oriented, GATT-centred trade policy agenda based on a work program which would breathe vitality into the GATT and assist the U.S. administration in containing protectionist pressures and Congressional demands for sector-specific reciprocity, the Commission is motivated somewhat differently. It sees a need to make the GATT work more effectively by adjusting to the Tokyo Round results and addressing those issues to which the EC and others are committed by existing obligations, including the various codes. It uses the GATT largely to manage its relations with the United States. Pressures do not appear to be strong within the Community to deal with services, trade-related investment requirements, or other issues on the U.S. agenda. There is less disposition in the EC to launch a new round of GATT negotiations at this stage, although the Commission is participating in efforts to develop an agenda. As during the Kennedy and Tokyo

Rounds, the EC is likely to insist on more limited objectives for any GATT work program and to act as a brake on U.S. ambitions and, by extension, Canadian aspirations.

Japan

Japan is heavily dependent on world trade for its economic well-being. It imports vast quantities of raw materials and exports a broad range of sophisticated manufactures to a variety of world markets. Japan supports the multilateral trading system embodied in the GATT and sees it as a useful tool to further integrate its economy into the world marketplace.

Japan is Canada's third largest trading partner and, if current trends continue, could well replace the European Community as Canada's second largest partner by the end of the decade. Two-way merchandise trade in 1984 was worth almost $12 billion, representing some 6 percent of Canada's total exports and imports. Canadians have been frustrated by their lack of success in penetrating the Japanese market for more sophisticated products. Less than 5 percent of Canadian exports to Japan are in the end-products category, while some 60 percent are in the category of crude materials. The rest of Canadian exports were in the form of fabricated materials. There are some hopeful signs that progress may be achieved in penetrating the Japanese market for certain sophisticated products, including the telecommunications area. Canadian imports from Japan have put certain pressures on individual sectors of Canadian production such as passenger vehicles. In this area of trade, the Canadian government has followed the practice of others and sought a reduction in the flow of vehicles to the Canadian market, but has done so in a manner that undermines the credibility of Canadian commitment to the international rule of law.

In essence then, Japan buys from Canada only what it needs, either to feed its people or to supply Japanese industry. Japan sells to Canada what it wants to sell, and Canadian tariffs and import regulations have not, by and large, represented a major constraint on Japanese marketing efforts. Canadian trade policy objectives concerning Japan have successively, and to little effect, sought to grapple with this problem of imbalance. The issues remain much the same. In spite of major efforts on the Canadian side and assurances from the Japanese government that it also is committed to economic and industrial cooperation with Canada, concrete results have been few. Examples of frustrated efforts by Canadian exporters in the face of Japanese restrictions of one kind or another are numerous.

Japan has developed a sophisticated approach to economic and trade policy which has resulted in the evolution of a highly competitive industrial structure capable of marketing capital and consumer goods aggressively and effectively around the globe. Japan has derived tremen-

dous advantage from the gradual reduction of international trade barriers, while at the same time effectively insulating its domestic economy from both foreign investment and import competition beyond the modest levels regarded as acceptable by the Japanese. The country is, however, vulnerable on four fronts: reliance on offshore energy supplies; reliance on offshore raw materials; reliance on offshore markets for its manufactured goods; and dependence on the United States in terms of its national security interests. Dealing successfully with Japan, then, is more than a GATT problem. It will require addressing Japanese vulnerabilities and developing a more satisfactory, longer term relationship between Canada and Japan in the context of these vulnerabilities. Of equal importance is the impact of Japanese trade and industrial policies and practices on other countries, particularly the United States. U.S. concerns are not dissimilar from those of Canada, but U.S. leverage in economic and political terms is considerably greater than Canada's. Of special concern is the potential for Japanese accommodation of U.S. interests in a manner which could be discriminatory and detrimental to Canadian trade (a concern which applies equally to bilateral trade arrangements involving the United States and the European Community).

Japan has become aware of foreign frustration with its import regime and the lack of penetration by foreign manufactured and processed goods into its market. A number of recent decisions by the government of Japan show that this awareness is being translated into positive action. A number of packages of specific unilateral and unbound trade concessions have been put forward to ease foreign pressure. These remain unbound in the GATT and can be withdrawn at any time. They have been largely responsive to U.S. and EC pressures and have been of limited benefit to Canada. As such, they are an effective illustration of the limits of a bilateral approach for Canada.

While generally committed to the multilateral system, Japan tailors its export and import practices to the needs of the moment and often prefers bilateral accommodation to pursuit of its rights under the GATT. Japan has never, for example, sought compensation for safeguard actions by its trading partners which largely affected its interests, nor has it resorted to the GATT dispute settlement procedures to solve its bilateral trade problems. Japan, however, has frequently been on the receiving end of GATT complaints, resort to conciliation, and safeguard actions. Japan's penchant for bilateral accommodation in a manner inconsistent with its GATT obligations has been an important factor in the erosion of the GATT safeguard system.

In its participation in multilateral negotiations, Japan has, by and large, avoided putting forward innovative proposals of its own, preferring instead to allow others to assume the leadership role. However, it follows developments closely and has shown itself willing to play a

constructive role in the evolution of the GATT system, although at times certain of its partners may become frustrated by the unique nature of Japanese decision-making procedures which can often take considerable time.

The Japanese share the general perception that it is important to maintain and strengthen the integrity of the multilateral trading system. Their approach, however, is more directly based on their own bilateral trade problems with the United States and the European Community. These bilateral trade problems have at times translated into a heightened determination to develop a positive and forward-looking multilateral trade agenda which will divert attention from specific bilateral irritants. However, the Japanese rarely put forward specific suggestions. This is not surprising, considering that they are on the defensive and bearing in mind the nature of their decision-making system. The Japanese did not formulate any specific suggestions in the preparations for the Kennedy and Tokyo Rounds and frequently develop their ideas on the basis of suggestions from the United States, the European Community, and Canada. Normally, Japan can be expected to be cooperative in addressing a wide variety of topics and to delay any specific decisions until the views of most other major participants have become clear. It has, therefore, been somewhat surprising but encouraging that the Japanese have been active since late in 1983 in initiating multilateral discussion, including Prime Minister Nakasone's consultations with world leaders advocating a new round of multilateral trade negotiations to "consolidate the free trading system and to inject renewed confidence in the world economy."

Developing Countries

The developing countries will probably be the most dynamic factor in international trade relations during the 1980s. Although it is difficult to group these countries under one heading because of their different levels of economic development, the more advanced developing countries have some of the most sophisticated manufacturing industries in the world and play a significant role in international trade. At the other extreme, the poorest developing countries have not yet reached a level of development at which they produce a variety of goods and exportable surpluses. Recent OECD studies examining trade patterns between the developed countries and the more advanced developing countries, i.e., the newly-industrialized countries (NICs), have demonstrated that the balance of trade is in favour of the developed countries. The NICs are important suppliers of a variety of goods to the Canadian market. While Canadian exports to these countries have risen dramatically over the past decade, the share of Canadian exports to these countries as a proportion of world trade is less than that for most OECD countries.

Clearly, there are considerable commercial opportunities for Canadian producers in these countries and continued efforts will likely be expended on attempts to develop these markets. The results, however, will be long term rather than immediate.

Most of the developing countries are contracting parties to the GATT but, because the developing countries have not been expected to participate in GATT trade negotiations on the basis of full reciprocity, they have not assumed the obligations within the GATT which have been accepted by the developed countries. One of the major international trade issues to be addressed during the 1980s and 1990s will be the question of the role played by the more advanced developing countries in the GATT system. There is widespread belief in the industrialized world that these countries should be making a contribution to the international trading system commensurate with the considerable stake which they have in the maintenance of an open trading environment.

Developing countries do not view the postwar trade and monetary institutions against the background of experience with depression and war and the need for postwar reconstruction. Many of these states are former colonies, poor, underdeveloped and often politically unstable. There is a marked tendency in the rhetoric of the developing countries to blame their poverty and dependent status on the system itself. Their arguments would suggest that they often regard the multilateral trade and payments system as a vehicle devised by the former metropolitan powers to continue exploiting their former colonies and to establish new dependencies through economic exploitation. In general terms, developing countries are seeking measures to improve their revenues from commodity exports in addition to reducing protection in the industrialized countries for their manufactured exports (particularly textiles, clothing and other standard-technology goods). Developing countries are also demanding measures of structural adjustment by the industrialized countries so that the latter will move out of labour-intensive, standard-technology industries.

The postwar liberal trading philosophy promoted by the United States and supported by Canada and other industrialized countries did not have, as one of its original objectives, a redistribution of the world's wealth on a more equitable basis. Nevertheless, the GATT system has led to an opening up of markets of the industrialized countries which would not have been conceivable under any other system. It is also important to remember that developing countries have not been expected to provide full reciprocity in terms of opening up their own markets. As pointed out by Jan Tumlir of the GATT Secretariat, trade rules, such as they are, are related to keeping markets open to trade rather than closed. Every country retains the right to protect its domestic markets, but the rules of the GATT place limits on this protection. Moreover, these limitations or obligations are relaxed explicitly for developing countries.

Tumlir goes on to say that "practice under the General Agreement has become so lenient that hardly a substantive obligation could be said to exist today which could not be waived or substantially attenuated in favour of a developing country."[21]

It is difficult to argue that developing countries, having almost unlimited rights to protect themselves against imports, could somehow be harmed by other countries keeping themselves open to trade. Even legitimate criticisms about the levels of protection established by many countries on developing country exports such as textiles and clothing are not altogether valid. Notwithstanding the protection, actual levels of market penetration of these products are substantial in many industrialized countries, although they would certainly be higher without the high level of protection these sectors enjoy. The GATT system is not a system which exploits developing countries; rather, it provides developing countries with some assurance of relatively open markets, particularly in comparison to the markets of the centrally planned countries, or to the markets of the developing countries themselves. For these reasons, it is unlikely that fundamental changes in the international trading system will be made in response to LDC demands. Any changes will be in response to more broadly based needs.

One of the complicating factors in understanding developing country interests is the tendency to regard the Third World as a homogeneous group. This, of course, is far from the case. It is not true of commodity interests, where many developing countries are importers as well as exporters. Neither is it the case with respect to concerns of developing countries about access to markets for their products. Brazil and Argentina, for example, account for 90 percent of the exports of temperate-zone agricultural products to OECD countries by developing countries and obviously would have interests different from other LDCs in opening up markets for these products. Progressive opening up of industrialized country markets, particularly for standard-technology manufactured goods, has been a major benefit to those countries on the leading edge of the developing world, including Brazil, Mexico, South Korea and Singapore. However, market access will not do much for the poorest countries of Africa and Asia, which have little of marketable value to sell regardless of the conditions of access to industrialized country markets. Similarly, the indirect beneficiaries of structural adjustments that would allow the industrialized countries to move out of standard-technology industries are likely to be the same few countries. It is noteworthy that the most active of the Third World countries are also, with some exceptions, among those which would benefit most from developing country demands. Somehow, the poorest of the developing countries, most in need of assistance, are not central to discussions.

State-Trading Countries

Foreign trade is a monopoly of the state in the U.S.S.R. and in the socialist countries of eastern Europe as well as in other states with similar economic systems, including China and Cuba. Although there are variations on the theme, in general the state monopoly is implemented by means of granting exclusive authority to import or export specific products to a number of foreign-trade organizations (FTO). Purchase decisions are not necessarily made on the basis of the preferences of end-users, or on the basis of the potential demand for products in the market. In addition, the decision-making process on contracts tends to be slow and cumbersome because of the bureaucratic process involved and the tendency to consider factors beyond strictly commercial ones. None of these countries has convertible currency, and all have increased their hard-currency indebtedness significantly over the past few years. Export credits or various types of compensatory trade arrangements are becoming more important factors in doing business. By far the largest proportion of Canadian exports to the state-trading countries is in the grains sector, although important contracts have also been concluded in the area of manufactured products. The Canadian Wheat Board effectively conducts state-to-state sales of grains to these countries, with which Canada runs a significant trade surplus.

Most of the state-trading countries of eastern Europe, with the exception of the Soviet Union, are contracting parties to the GATT. China is not a contracting party to the GATT, although it asked to participate as an observer in the GATT Ministerial meeting in 1982 and became a member of the MFA in 1983. The GATT system was designed originally as a framework for trade among countries with open market economies, and the GATT rules do not readily lend themselves to dealing with the problems encountered in trading with these countries. Nor do the major state-trading countries accept in practice the thesis, which underlies the participation by the Western industrialized countries in the trading system, that trade will lead to the more efficient allocation of resources and produce benefits for all. By and large, the state-trading countries participate in the international marketplace only when they have particular requirements which they cannot meet internally. These countries generally have policies which aim at self-sufficiency and it is more difficult, therefore, to build a long-term diversified trading relationship with them.

Chapter 4

Canada's Economic Development Policies: Constraints and Opportunities

> National industrial policies are responsible for some of the greatest difficulties in the international trading system. . . . To be sure, the right blend and timing of measures in an industrial policy can also contribute to growth, productivity and efficiency. But societies are rarely satisfied with efficiency and economy alone; they want security, diversity, autonomy, the preservation of ways of life, the improvement of the environment and many other values as well.
>
> — Miriam Camps and William Diebold
> in *The New Multilateralism*

It is not the purpose of this chapter to provide a detailed description of Canada's economic development policies. Sufficient studies exist to provide such a detailed catalogue.[22] Rather, this chapter seeks to provide an overview of the purpose and nature of the range of economic development instruments available to the government, how and why they are established, and how they are affected by international commitments and practice.

Canada has been variously described as a resource-based economy, a trading nation, and an industrialized country, and increasingly as having a service-oriented economy. In a sense, all four descriptions are accurate; each describes one dimension of the economy. Canada is well endowed with mineral, agricultural, forest and fishery resources; its growth as a nation has been influenced largely by its ability to extract, grow and exploit these basic resources. At the same time, Canada can no longer be considered merely a "hewer of wood and drawer of water": Canada now also boasts a sophisticated and diversified industrial base providing a range of semi-processed and fully manufactured products. Furthermore, more than many other industrialized nations, the health of

the Canadian economy is determined by the ability of Canadian producers and manufacturers to penetrate foreign markets: some 30 percent of our prosperity is drawn directly from exports. Recent Canadian trade performance also reflects the importance of the first two factors and their changing roles. Some 60 percent of Canadian exports remain resource-based, but an increasing proportion of exports consists of goods further processed in Canada. Only some 30 percent of current Canadian exports constitute raw materials. Finally, some two-thirds of Canadians now work in the service economy and, during the past decade, four out of five new jobs have been found in this sector. Viewed from another perspective, only one-third of Canadians are now engaged in producing goods for foreign and domestic consumption. It is in this context that it can be said that the future of the service sector will increasingly determine the nature of the Canadian economy.

To a great extent Canada's further economic development will be conditioned by how well federal and provincial governments respond to the requirements of all four dimensions of the Canadian economy in developing responsive and responsible economic development policies. The nature and scope of present Canadian economic development policies will influence heavily the future direction of Canada's economic growth. While healthy skepticism has developed in recent years about the virtue of government intervention in the economy, it is a fact of modern life that governments in all Western countries have taken greater responsibility for economic welfare and participate more extensively in the economy. In Canada, direct government expenditures at all levels now constitute some 47 percent of GNP, an indication of the extent of government influence. The issue in recent debates has not been about whether governments should intervene in the economy, but about the instruments used, the purpose and the extent.

All industrialized countries today seek to develop and integrate various government policies and programs into a coherent strategy aimed at furthering the nation's competitive position, promoting selected industries, smoothing the adjustment burden, selectively supporting regional expansion and generally fostering economic growth.[23] Even in the United States, where politicians frequently proclaim their dedication to the free-enterprise system, there exists a broad mix of government policy instruments to reach clearly articulated goals. Canadian governments have demonstrated both a commitment to the market and a readiness to insert a high degree of government participation in the economy to reach objectives considered unachievable by market forces alone. It has, therefore, been described as a mixed economy, i.e., incorporating state planning within a free-enterprise system. This general approach was stated in 1982 by then Finance Minister Marc Lalonde:

> Canada's economic development strategy has always been a pragmatic one, free of ideology, relying upon both international investment and public enterprise to supplement private domestic investment. . . . It has been a key factor in what is perhaps our greatest achievement: the successful blending of our cultural and regional diversity into a modern, competitive economy, with a long tradition of political and social stability.[24]

Historically, the tariff was the principal instrument of government industrial policy, supplemented by other measures (e.g., land grants, a transportation network and, in recent years, Crown corporations). Since World War II, as the tariffs of industrialized countries gradually came to be reduced through a process of multilateral negotiations, a sophisticated array of other instruments was developed to achieve similar objectives including full employment, further industrialization, regional development, and productivity growth. In addition, as expectations about the role of government increased, so did the need for various programs and instruments to respond to these expectations. In Canada, because of the division of powers between the provinces and the federal government, both levels of government have increasingly perceived their political interests to lie in the development and use of highly visible and specifically directed instruments. Some of these programs and policies have been complementary; others have been contradictory. Taken together, they constitute a major influence on private sector business decisions.

Describing Canada's actual, day-to-day approach to economic development is not an easy task. No blueprint or master plan exists, there are frequent shifts in direction and false starts for various components of the strategy, and there is in general a gap between intention and execution.[25] Recent examples of federal government statements of its general approach to its economic strategy can be found in the 1981 budget document *Economic Development for Canada in the 1980s* and in the 1984 economic statement *A New Direction for Canada — An Agenda for Economic Renewal*. Documents such as this constitute more a statement of good intentions than a guide to actual practice. Nevertheless, they set out the principles and priorities which guide the policy and program action of the federal government. Both underlined the role of trade and the international competitive environment in strengthening the Canadian economy and in promoting the continued development and expansion of the resource-based industries and the revitalization of industrial capacity toward specialized international competitiveness. The government thus establishes a framework within which individual policies and programs can be developed and implemented by the federal government, and hopefully by provincial governments.

An essential problem in the pursuit of economic development has always been how to reconcile conflicting priorities for national objec-

tives with what is needed for a stable international economic system (e.g., full employment or regional development, or the need to protect essential industries such as war industries and agriculture for strategic or political reasons). There is no simple or final solution to the problem. Resolving the inherent conflicts is a continuing process of negotiation and compromise at both the domestic and international levels. It calls for governments to formulate new policies frequently, and to operate them in an environment of constant tension between the forces of protectionism and liberalization. An overriding, but frequently ignored, priority in this context is to ensure that efficient Canadian producers are not disadvantaged by narrow social and political considerations. Government policies in this context involve hard political choices best taken in the full knowledge of the internal and external constraints and opportunities.

Historical Overview of Policy

For more than a hundred years now — ever since Sir John A. Macdonald introduced the National Policy in 1879 — successive Canadian governments have sought to encourage the widest possible range of manufacturing in Canada to complement and make the best possible use of Canada's rich endowment of natural resources. Over the years, the means to achieve this goal have included commercial, industrial, fiscal and monetary measures: tariffs, subsidies, tax incentives, licensing, a stable dollar, quantitative restrictions and Crown corporations, to encourage manufacturing and to influence the flow and type of exports and imports. This strategy always had a strongly protectionist and interventionist quality in order to encourage diversification and preserve employment, where less directed economic policies might have led in opposite directions.

Canada's commitment to the principles of the GATT and other multilateral institutions in the late 1940s constituted a basic change of direction favouring openness and interdependence. This change was foreshadowed by negotiations with the United States in 1935 and 1938. Canadian governments had always recognized that Canada's continued growth would require relatively unfettered access to foreign markets, but in the face of a worldwide penchant for protectionism (particularly U.S. protectionism in the 75 years prior to the Reciprocal Trade Agreements Act of 1934) and limited domestic manufacturing capacity, protectionism to encourage the development of a more diversified industrial base appeared to be the better policy.

In the first half of the 20th century, the Canadian tariff on industrial products was among the highest in the world, although not as high as the U.S. tariff. It succeeded, nevertheless, in encouraging a high degree of industrialization. Further industrialization was stimulated by the

1939–45 war effort. This was a mixed blessing. The industrial structure which developed behind high tariff walls was highly fragmented, characterized by small production runs and many foreign-owned branch plants, and generally was not internationally competitive. Tariff cutting since 1935, but particularly under the GATT in the past 20 years, has sought to encourage Canadian industry to rationalize, specialize and become integrated into world markets. This process has been facilitated by being undertaken within a framework of multilateral rules and procedures which allowed cuts in the Canadian tariff to pay for improved access to foreign markets, thus further encouraging the process of rationalization and specialization. Improved access conditions allowed competitive Canadian suppliers to penetrate foreign markets, thus increasing the size of production runs and improving productivity, especially for further processed indigenous raw materials. Canadian trade policy always has entailed a constant process of negotiation meeting both export and import objectives.

The postwar liberal multilateral order has provided an international framework within which to pursue a more outward-looking policy mix. It brought with it an acceptance that some sovereignty would be sacrificed and that popular protectionist policies would have to be forgone in order to gain greater access to world markets. On the whole, Canadian governments initially displayed a remarkable adherence to this early postwar spirit. In the last decade, however, there has been a noticeable erosion in Canada's acceptance of the obligations inherent in a multilateral system. Two factors stand out in explaining this erosion. One has been the growth in nationalism. The diminution of sovereignty that is inherent in interdependence is no longer accepted as readily, especially when others are perceived to be taking their obligations less seriously. The second has been the transition from a developing economy to an adjusting economy. While frontiers remain, Canada on the whole is now a fully industrialized economy with fully developed primary, secondary and tertiary sectors that contribute to the development of wealth. A fully developed economy, however, needs to adjust constantly to changing circumstances to remain internationally competitive. Adjustment poses more difficult policy choices than development because it must deal directly with vested interests and potential losers.[26]

Adjustment in an interdependent world can be difficult and can complicate the development of palatable choices. Thus nationalism and the maturation of the economy have eroded the earlier confidence in multilateralism and interdependence. Yet, as was pointed out earlier, today's multilateral world is essentially one that allows for no escape, especially for a country that depends on outside markets for 30 percent of its wealth. Autarky is not a realistic alternative, even though policies tending toward autarky may at times be politically expedient. Trade involves both exports and imports, and it is not possible for all traders to increase

exports and reduce imports at the same time. Thus, autarky does not make much business sense.

In pursuing economic development policies for a much more sophisticated economy, well integrated into world markets, recent Canadian governments have found that the multilateral rules and international competition are less constraining for trade in primary products than for more sophisticated ones. Most primary industrial products enjoy relatively free access to world markets, and rules concerning such matters as subsidization do not apply to the same extent. Prices, however, are much more volatile, introducing a constraint of their own. Trade in temperate-zone agricultural products is less constrained by the rules than by the protectionist practices which impede access to all major markets and by the practice of others in third-country markets. To a large degree, liberal trade policies and the full range of GATT rules do not apply to this sector. The changing composition of Canadian exports, however, toward more fully processed products has brought Canada into the mainstream of international trade policy. For the first 20 years of Canadian participation in the GATT, Canada accepted obligations which had limited practical effect and gained opportunities of great potential value. This situation began to change as Canada's manufacturing sector grew. Trade in semi-processed and fully processed products is the mainstay of the GATT, and problems of competition and adjustment are particularly prevalent in this kind of trade. GATT obligations thus began to bite, and improved access became more difficult to achieve as Canadian participation in trade in manufactured goods grew.

During the period 1958–73, world trade and the industrial economies grew at a rapid pace, and the generally favourable international economic situation placed relatively few constraints in the way of Canadian policy makers. Since 1973, the constraints have multiplied and those imposed by commitments under international agreements and arrangements, while not new, have begun to chafe. Canada is heavily dependent on external markets, but the benefits of interdependence and multilateralism are more apparent during good times than bad. Nevertheless, multilateral and bilateral commitments can promote stability and order in domestic policies. They can provide a stabilizing rudder to mitigate swings in policies reacting to the pressures of the moment. The private sector wants stability and predictability when it makes long-term investment decisions, even though it may not like a particular denial of a quota or a subsidy.

The Range of Available Instruments

Governments have increasingly taken responsibility for national welfare through a wide mix of social and economic programs. The 47 percent level of participation in the economy referred to earlier gives Canadian

governments significant scope for influencing the performance of the economy, as well as a large responsibility. In pursuing such goals as growth, stability and full employment, the federal government uses a range of macroeconomic instruments (including monetary policy, exchange rate policies, fiscal policy, tax policy, policies affecting investment, and regional development policy) to provide an environment within which the private sector can plan, invest and operate with confidence. In practice, in a free-enterprise society these framework instruments are meant to facilitate the smooth operation of the market. They are aimed at the economy as a whole and generally are not directed toward particular economic activities. Ultimately, they are meant to promote the most efficient allocation of Canadian resources and the strengthening of international competitiveness, as well as the redistribution of income among individuals and regions. By contrast, the microeconomic instruments are directed toward specific sectors, economic activities or factors of production. Macroeconomic instruments provide the framework or environment within which the government encourages adjustment toward a more efficient allocation of resources. Microeconomic instruments, on the other hand, seek to smooth the path of adjustment and protect, encourage or discourage particular economic activities.

The government's overall strategy for the economy is normally adjusted each year in the budget which, in addition to the minister of finance's statement to the House of Commons, today encompasses massive documentation and a host of related procedures including the economic budget, the expenditure budget, the fiscal framework, the main estimates and supplementary estimates. The budget establishes fiscal, tax and monetary targets, the means to achieve these targets in the light of the government's assessment of the current and forecast state of the economy, and the steps needed to maintain or improve the economy's long-term economic performance. As has been noted by the governor of the Bank of Canada, the government's ability to carry out its strategy, however, is not without limits:

> The overwhelming mass of decisions about what to produce, how to produce it, where, when, to whom and for how much to sell it, what use to make of the income generated in the process of production and distribution — most of these decisions are taken by individuals or private groups related to each other by markets. In a society like ours, public economic management relies mainly on influencing the framework — within which markets operate.[27]

In addition, the fact that Canada is a federal state severely limits the federal government's influence over the economy's performance. For example, a federal strategy of restraint can be readily frustrated by seven or eight provinces pursuing strategies of stimulus and growth.

In today's interdependent world, budget making and the use of various

supporting instruments are also conditioned by Canada's perception of its place in the world, and by the bilateral and multilateral commitments entered into by successive Canadian governments. It is essential that governments today recognize that economic and trade policies which are far out of step with those being pursued by the country's principal trading partners are likely to be counter-productive and can increase the eventual burden of adjustment as well as the cost to governments. Canadian interest rates much lower than those in the United States, for example, would encourage an outflow of capital and place serious pressure on the value of the Canadian dollar, in turn affecting the flow of exports and imports and the pace of adjustment. Multilateral institutions are helpful in the process of managing this interdependence in an orderly fashion, and they provide the framework for almost continuous consultations. Generally speaking, the international monetary system centred on the IMF influences the use of the macroeconomic instruments, supplemented by the OECD and the annual Economic Summit. The GATT and the international trading system constrain the use of the microeconomic instruments. In the rest of this chapter, a few examples will demonstrate how these influences and constraints operate in practice.

Fiscal and Monetary Policy

Fiscal, tax and monetary policies are the three principal macroeconomic levers available to the government. By its monetary policy the government controls credit, interest rates and the money supply, all with a view to maintaining the value of the national currency; by its fiscal policy, it establishes the relationship between the government's income and its expenditures, as well as the nature of its expenditures; and by its tax policy the government establishes how it is going to generate its income. These three levers are meant to be mutually reinforcing, but because of a variety of factors, they do not always meet expectations. International commitments, however, help the government to pursue a consistent and predictable course.

The day-to-day management of monetary policy in Canada is largely the responsibility of the Bank of Canada, established for this purpose in 1935. The Bank's independence seeks to shield the making of monetary policy as much as possible from immediate and short-term political considerations. The governor of the Bank of Canada, however, consults frequently with the minister of finance, and their respective officials are in almost daily contact. Central bankers, nevertheless, find that they too can be targets of political pressures, especially during bad times. Most people, including politicians, prefer easy money and low interest rates, and few governments are elected on a platform of tight money and high interest rates. The discipline of tight money and high interest rates, however, is needed in certain circumstances to dampen inflation and

ensure long-term competitiveness. The role of monetary policy in ensuring the effective working of the market is limited by a number of commitments and practices arising out of Canadian participation in the multilateral trade and payments system.

Both the IMF and the OECD undertake periodic in-depth analyses of the performance of the economies of member countries and the efficacy of the policies being pursued by member governments. These analyses are based on a survey of available national and international data and measurements, as well as detailed interviews with government officials and consideration of government statements. The resultant reviews are often critical and always informative and, because they are publicly available, they enjoy a high degree of moral suasion and authority. Governments are committed to assisting in the preparation of these reviews and are resigned to the occasional embarrassment. Democratically elected governments, however, can ill afford a consistent record of embarrassment. IMF and OECD economic and statistical surveys which demonstrated that Canada's inflation record was worse than most other OECD countries in the late 1970s were a factor in convincing the government to change its course and stop shielding the Canadian economy from the burden of international adjustment through, for example, lower energy prices, a policy prescription it had maintained in the early 1970s. Recent equally critical comments about the size of the government's deficit and the burden of servicing the public debt may influence the direction of future government tax and fiscal policies.

Political commitments undertaken at economic summits act as a similar constraint. Canadian governments have found it difficult to tell their electorates that they are going to pursue a hard course for a period of years, and they have found it just as difficult to stick to such a course, especially if it involves increased unemployment, high interest rates, and restraint in social spending. Taking such steps in concert with others, particularly the other six summit partners, appears to make the bitter pill easier to swallow and the need for it more convincing. It is like losing weight. While the need for it may have been apparent for some time, membership in a weight watchers group may make it easier to practise self-restraint. Constraints arising out of summit membership are thus largely psychological and arise out of a desire to be part of the club of economically most powerful nations. Failure to conform to the rules of the club could lead to summits to which Canada is not invited.

A more direct obligation arising out of IMF membership is the commitment not to manipulate exchange rates in order to export unemployment and shield adjustment. This was a relatively straightforward commitment during the era of fixed exchange rates, when any movements were subject to close consultations with the IMF. It is more complicated under a system of floating exchange rates, when the line between per-

missible intervention to promote orderly trading conditions and intervention to gain temporary advantage and avoid adjustment can be a fine one.

The breakdown of the Bretton Woods system of fixed exchange rates had a powerful impact on governments and taught them the value of meaningful multilateral commitments. It brought back the old problem of competitive exchange rate manipulation and underlined the need for a workable solution in an era when rapid and fundamental adjustment requirements are a recurring problem and when governments are eager to find ways to ease or even avoid the adjustment burden. Canada has had relatively more experience with a floating exchange rate than most major trading nations, having introduced a floating regime between 1950 and 1962 and, later, from 1970 onward.

The commitment in the multilateral system to manage government financial and economic policy so as not to export unemployment and avoid adjustment has to some extent been undercut by the fact that there is little consensus today as to what course meets this obligation. The debate goes on as to whether demand management, supply management, monetarism, non-accommodating, or countercyclical policies fill the bill. As a result, consultation at the IMF, the OECD and summits has become an increasingly important factor. During such consultations, the major countries seek to reach consensus on the most appropriate course for their macroeconomic policies. Such a consensus often involves individual short- to medium-term commitments within the broader framework of the IMF.

Within the international monetary system, however, the IMF holds the trump cards. A government that repeatedly mismanages its economy will soon find that it cannot pay its way internationally and may soon require loans from the IMF or other sources to safeguard the balance of payments. For an open economy like Canada, this is a real constraint. Balance-of-payments assistance is available from the IMF, but it comes with strings attached, both real and psychological. IMF assistance leads to much more stringent examination of the economy, the right (or obligation) to take measures which can adversely affect others, the obligation to consult, and ultimately a prescription for appropriate adjustment measures by the IMF. Major developing countries have in recent years felt the sting of IMF requirements. No government of a major industrialized country can afford to let developments in its economy reach this stage. It is in this sense that IMF obligations act as a major constraint. This constraint, however, is in fact an opportunity. It encourages stable and positive economic management and discourages short-term, manipulative policies which undercut a country's long-term competitiveness.

Protection and Industrial Development

The tariff was historically the principal device used by governments to protect domestic industry and to promote industrial development. The experience of the 1930s demonstrated, however, that protectionism could assume many faces: high tariffs, subsidies, export incentives, exchange rate manipulation, and quotas. In the past decade, as tariffs have gradually been reduced, this fact is again becoming apparent in a situation which has been described as the new protectionism. Unlike the 1930s, however, there now exists a much more developed set of international rules to constrain the attraction of protectionist or mercantilist measures.

For ease of analysis, protection (the abuse of which is commonly considered protectionism, i.e., measures which cannot be justified within the existing rules) can be divided into four classes:

- regular on-going protection, i.e., protection extended at all times and which operates principally at the border, the most common variety being measures such as tariffs and selected agricultural quotas;
- selective protection, i.e., protection accorded to specific products from time to time to offset serious injury and to promote adjustment, commonly in the form of quotas, surcharges, subsidies, minimum import prices, tariff-rate quotas;
- conditional protection, i.e., protection extended to specific products when and if certain conditions are present such as dumping, subsidization and consequential injury to domestic producers; the measures applied are usually special duties to offset the margin of dumping or subsidization and prevent injury, but can also include undertakings by the exporter regarding price or quantity; and
- incidental protection, i.e., measures taken principally for reasons other than protection but which incidentally affect the flow of imports or exports: various import replacement policies, regional development grants, licensing, marking requirements, product standards, phyto-sanitary regulations, government procurement and the operation of agricultural marketing boards. In some cases, the protective effect may also be intended; in others it is purely incidental.

From the outset, the GATT has sought systematically to contain these practices within clearly understood rules. Over the years, provisions which were only sketched out in the General Agreement have been clarified through practice, working parties, findings by panels, new understandings and, during the Kennedy and Tokyo Rounds, detailed ancillary agreements. In addition, the GATT provides a forum for consultation and procedures for settling disputes. Although it is not possible to describe in detail how individual Canadian policy decisions in this area have been conditioned by the international rules, a few examples will illustrate how extensive this process has been.

The Tariff

While tariffs have traditionally been used by governments to influence economic development, at the same time they have been used to raise substantial revenues. Even today, tariff collections amount to $3 billion annually. The National Policy of 1879 relied on high tariffs to encourage industrial development, and remained the basis of Canadian trade and industrial policy until the 1940s. Those high tariffs were also one of the government's principal sources of income. When Canada joined 22 other nations at Geneva in 1947 to conduct the first-ever multilateral tariff negotiation, the Canadian general tariff was in the order of 25 to 40 percent, i.e., at prohibitive levels for many products. Some goods, however, attracted a much lower tariff if they came from British countries (i.e., the British Preferential tariff extended and agreed by Britain and the Dominions at the Ottawa Conference in 1932) or came from countries with which Canada had exchanged most-favoured-nation treatment (including the United States, following negotiations in 1935 and 1938).

The 1947 GATT negotiations were distinguished by the fact that 23 countries, negotiating concurrently, would immediately multilateralize their bilateral concessions on a most-favoured nation basis to all other GATT members. The process involved countries seeking improved access to foreign markets for their exporters and paying for this access by lowering barriers to their own market. A participant's negotiating leverage was thus directly related to the size of its market and its willingness to improve access to the market. The negotiations were conducted within a set of rules designed to protect the integrity of the agreed concessions. The rules, the General Agreement on Tariffs and Trade, have for close to 40 years provided the framework under which, at last count, some 132 countries conduct their tariff policy. Some six further rounds of GATT negotiations were subsequently held so that, by 1987, the average incidence of the tariffs of industrialized countries on industrial products will be below five percent. Tariffs that remain today are used primarily to protect prices and incomes.

Under Article I, the GATT establishes the basic most-favoured-nation (MFN) rule, i.e., that any tariff concession extended between any two contracting parties is immediately applied to the trade of all contracting parties. Article I permits the continuation of preferential tariffs existing at the date of accession to the GATT, such as Canada's British Preferential (BP) tariff, but stipulates that the margin of preference cannot be increased. As MFN tariffs were reduced gradually through six further rounds of negotiations, the value of preferential tariffs has been greatly eroded. The introduction of generalized preferences, by Canada and other industrialized countries in favour of developing countries in the 1970s, was permitted under a waiver, further reducing the value of

Canada's pre-existing preferences. For Canada, only New Zealand and Australia still enjoy contractual tariff preferences; these are bound under bilateral trade agreements and permitted under GATT Article I:2 and 4.

GATT Article II specifies that the schedules of lower tariff rates and other concessions bound in GATT negotiations form an integral part of the Agreement. These schedules contain only concessions negotiated and bound against further increase in the GATT. For most of the industrialized countries, including Canada, this now extends to virtually all MFN tariffs. The binding of a tariff in and of itself is also of some value. In practice, reductions below bound rates are quite common and are called "applied" rates. The binding of such a lower, applied rate is again of value and can be used to pay for improved access to export markets.

Contracting parties are prevented from increasing bound tariffs except under established procedures. Article XIX permits increases in tariffs for temporary periods whenever any concession gives rise to serious injury resulting from circumstances unforeseen at the time the concession was made. Under procedures established in Article XXVIII, any contracting party may be authorized (by the contracting parties acting collectively) to make changes in any bound concessions by entering into negotiations with interested parties. The interested parties are deemed to be the contracting party to whom the concession is bound, the principal supplier of the product in question, and all contracting parties with a substantial interest in the trade of the product concerned (usually taken to mean 10 percent of the import market for the product concerned in the market of the party seeking an increase). During such negotiations, interested parties may agree to the proposed increase, in exchange for a decrease in the duty on another product or some other concession considered to be of equal value. Should agreement among the interested parties not be reached, the contracting party is free to proceed with the increase and any adversely affected party can withdraw a concession of equivalent value. There are procedures established to facilitate the settlement of disputes and restore the overall balance of concessions. The objective is to seek trade-creating solutions, rather than trade-limiting or trade-distorting ones.

Canada, along with most industrialized countries, has introduced a general preferential tariff (GPT) column for many products. This lower tariff is available to developing countries that meet the criteria. While extended unilaterally and not constrained by legal obligations, the continuation of the GPT is protected by a strong political commitment, and its withdrawal would adversely affect Canada's relations with developing countries. There now exist, however, special safeguard procedures to withdraw temporarily a preferential tariff when the Tariff Board is satisfied that its continuation would seriously injure Canadian producers.

Article VII and the Tokyo Round Agreement on Customs Valuation ensure that duties for ad valorem tariffs are calculated on the basis of an agreed set of criteria. Canada long had a "fair-market" system of valuation. It was a frequent target of complaint and was characterized as arbitrary, unique and tantamount to a non-tariff barrier in itself. During the Tokyo Round, Canada agreed, subject to being allowed to negotiate offsetting tariff adjustments, to convert its valuation system by 1985 to broader international practice by adopting the Brussels definition of value long used in Europe and codified in the Tokyo Round Agreement. Similarly, Canada has a unique tariff nomenclature system which it has agreed in principle to replace in the second half of the 1980s with the modernized version of the Brussels tariff nomenclature, the Harmonized System, now being finalized by the Customs Cooperation Council (CCC). Both these changes will fundamentally alter the Canadian tariff system and make it much more transparent and predictable for traders, in line with widely accepted international practice.

The general effect of the obligations contained in the GATT and the less formal procedural rules codified in the Kyoto Convention and administered by the Customs Cooperation Council is to make Canadian tariff policy and procedures clear, standardized, and less subject to manipulation for narrow sectoral ends. Both the GATT and the CCC provide procedures to help possibly aggrieved parties find satisfaction and resolve disputes regarding tariff procedures.

For Canada, the binding nature of tariff concessions has serious implications for industrial policy. It is not possible to adjust tariffs up and down to take account of the changing needs of an industry without engaging the interests of Canada's trading partners. Similarly, the negotiation of a sectoral, bilateral trade agreement with the United States to stimulate a particular industrial sector's performance violates the GATT and would thus require the agreement of other contracting parties or risk retaliation by adversely affected trading partners. Thus the fine-tuning of tariffs to meet industrial policy objectives has been significantly constrained by Canada's international commitments.

While Canadian tariff policy is largely constrained by multilateral commitments, there are also bilateral commitments. As was noted earlier, the preferential BP tariff still enjoyed by Australia and New Zealand is protected by two bilateral trade agreements. The New Zealand agreement was renegotiated a few years ago and negotiations are currently continuing to bring the Australian agreement closer to current practice and requirements. By virtue of these agreements, Canadian exporters enjoy similar preferred access to the Australian and New Zealand markets.

For certain trading partners which are not parties to the GATT, MFN tariff treatment has been extended under bilateral agreements. For example, for the U.S.S.R., China and East Germany, the right to enjoy

Canada's MFN tariff is of considerable value. Without it, they face tariffs in the 20 to 40 percent range and up to 80 percent for some products, e.g., vodka. Because the tariff is meaningless for centrally planned economies, Canada seeks other concessions from these countries, such as purchase commitments for wheat, in return for access to the MFN tariff. Canada's withdrawal of tariff concessions from these countries would place at risk large and important sales of wheat and other products to these markets.

A similar approach has proved of little value with OPEC countries, many of whom are not GATT members, because their principal export, crude oil, is duty-free from all sources. For these countries, broadly based cooperation agreements include exchange of MFN treatment for the few non-oil exports they offer (e.g., pistachio nuts from Iran). In the case of Mexico, which postponed GATT membership after applying a few years ago, both its market and its exports are of considerable interest to Canadian traders. Under a full-fledged trade agreement, imports from Mexico are entitled to MFN tariff treatment.

Incentives and Assistance

The GATT takes a dimmer view of subsidies than of tariffs. This position is directly opposite to the view of economists and reflects the fact that the GATT was negotiated among government officials. Subsidies cost money; tariffs raise money.[28] It also reflects, however, the view of U.S. trade officials in the 1940s. The U.S. view of subsidies as incompatible with a free-enterprise system was reflected in the U.S. proposals for an international trade organization. This view was not wholly shared by other governments but its general orientation prevailed in the General Agreement. Article XVI proscribes all export subsidies except those on primary products, where the obligation is to seek to avoid serious prejudice to the interests of others and where U.S. agricultural programs required the acceptance of subsidies. In addition, Article XVI provides that all contracting parties notify the GATT of any subsidy practices which, directly or indirectly, may operate to increase exports or decrease imports — and there is a consequent obligation to consult with a view to removing or limiting any subsidy considered to be prejudicial to the interests of production. The effect is, and was meant to be, a serious constraint on subsidy practices intended to favour industrial production.

Despite this originally negative view of subsidies codified in the GATT, Canadian governments, like those in other industrialized countries, have instituted a variety of incentive and assistance programs to help Canadian industry adjust to changing international competitive circumstances and generally to promote industrial development. These practices have become more widespread in the past ten to fifteen years as the

Canadian economy has become more open to international competition and as the need for adjustment has become more apparent. A further important consideration in the Canadian context was the desire to encourage regional development. A veritable alphabet soup of acronyms standing for general and specific incentive and assistance programs, policies and agencies has been developed (e.g., EDP, PAIT, ILAP, CIRB, ARDA, GAAP, FTAP, DREE, IDAP, RDIP, GDAs, SDAs, ARDP, PIDP, FDAP, PPP, PEMD, CCC, C-MIRB, SIAP, CDC, CIDC, DEVCO, etc.).[29] In addition, various tax programs seek to encourage or assist particular economic activities.

This development was not unusual among OECD countries and suggested that the general commitments of the GATT might not be sufficient to maintain order. Few governments appeared to be living up to their notification and consultation obligations. The proliferation of these programs had proved costly and the number of programs in various countries were to some extent mutually offsetting and not necessarily achieving benefits commensurate with their cost. A major exception to this general development was continued U.S. suspicion of overt subsidy programs, although it has been suggested that the U.S. defence program is the largest subsidy program in the world and that such tax practices as the Domestic International Sales Corporations (DISC) and tax-free municipal bonds also act as major incentives to industrial development. Two developments since the mid-1970s have acted as a brake on enthusiasm for further subsidy programs in Canada: U.S. countervail practice and the GATT subsidies code.

Since 1890, the United States has had a provision in its trade law for imposing a countervailing duty on any dutiable imported product found to be benefiting from a bounty or grant (i.e., a subsidy). This law was meant to offset foreign governments using subsidies to circumvent the protective effect of the U.S. tariff. The 1974 Trade Act added subsidization on duty-free products and an injury test for such cases. Because it constituted new legislation, it had to comply with the requirements of GATT Article VI. The U.S. Congress was by then of the view that foreign government subsidization was growing, and that it threatened U.S. interests. The 1974 Trade Act thus also inaugurated a much more vigorous pursuit of the countervail law. In numerous cases in the 1970s, U.S. authorities expanded the scope of the law; Canadian subsidy practices were no exception. First, steel belted radial tires manufactured by the Michelin Tires Company were found to have benefited from various federal regional development incentives and Nova Scotia assistance, and were countervailed. This decision was followed by a similar decision involving glass beads from Saskatchewan. In 1979, optic liquid level sensors manufactured by Honeywell Canada Ltd. were found to have benefited from PAIT research and development assistance. Three different findings were made against groundfish products involv-

ing a number of federal and provincial programs. There appeared to be no end in sight to the constraint on Canadian exports imposed by U.S. countervailing duty legislation and procedures. These constraints were particularly galling because U.S. procedures did not include an injury test for dutiable products as required by the GATT. The U.S. law predated the GATT and was not amended to conform to the GATT, in keeping with the Protocol of Provisional Application.[30] In addition, because Canadian companies benefiting from a grant invariably export a good part of their production to the United States, they were likely soon to fall afoul of U.S. law. U.S. companies, not likely to export more than a small percentage of their production to Canada, had little to fear from a more vigorous prosecution of Canadian law. U.S. prosecution of its rights under the GATT, therefore, provided a major constraint on Canadian subsidy practice.

During the Tokyo Round, contracting parties tackled the thorny issue of subsidization and its effects fully for the first time. More was at issue than the U.S. countervail law and lack of an injury test. Delegations struggled with questions such as the legitimacy of subsidization, its effect on exports, import substitution and competition in third markets. The result was the GATT Code on Subsidies and Countervailing Duties.[31] The Code recognizes the legitimacy of subsidies and notes that governments use them to promote important objectives of national policy, but that they may have harmful effects on the trade and production of others. It is interesting to note that the GATT, despite its generally more positive orientation toward tariffs, has never given similar recognition to tariffs. The Code also notes that countervailing measures may impede international trade as well. It develops a detailed construction of procedures, building on the provisions of Articles VI, XVI and XXIII. The negotiators hoped that as a result of the Code, governments would develop responsible national procedures and notify both subsidy and anti-subsidy practices so that a case law system gradually would bring more order into international practice. The Code in its early application has failed to come to grips with the issue of agricultural subsidies. The difficult trade relations issues arising from agricultural trade in the early 1980s hinge in large part on agricultural subsidies, both for domestic production and for exports to third-country markets. This was an important issue at the 1982 GATT Ministerial meeting and will probably remain high on the international trade policy agenda throughout the 1980s.

Canada extensively revised its legislation governing countervailing duty procedures in the light of the Tokyo Round Agreement in new legislation passed in 1984 in the House of Commons as the Special Import Measures Bill. Various Canadian subsidy practices have been challenged in the United States, but there have been no major decisions to impose new countervailing duties under the new law. Two notable cases involved softwood lumber and subway cars. Both cases, although

they did not result in the imposition of duties, acted as powerful reminders of the continued need to determine for each proposed new program the potential risk of countervail and to weigh that risk against possible benefits. Businessmen are unlikely to avail themselves of a program if the end result is costly harassment in their principal export market.

Export Credits Policy

Almost all industrialized countries have established government-supported facilities to extend medium- and long-term export credit, principally to facilitate the export of capital goods and services, often to developing countries. In Canada, the Export Development Corporation provides this service, and it has entered into many bilateral agreements to provide a framework for extending, guaranteeing or insuring credit.[32] The 1984 federal budget injected $1 billion into the export credit fund. Export credits, however, can be used unfairly to advantage one country's exporters over those of another. Such competitive export credit practices can become expensive and destructive. Canada, with one of the smaller treasuries among OECD countries, has therefore seen advantage in constraining the capacity of governments to enter into such competitive bidding — despite the occasional frustration this causes for the individual company trying to complete a major sale or a minister seeking political credit for such a government-assisted sale. A number of multilateral institutions and rules provide this constraining authority.

Most credit-insuring and -extending institutions are members of the Berne Union (the International Union of Credit and Investment Insurers), through which they exchange credit information on potential clients and seek to harmonize general policy and practice in the field of credit and investment insurance. While the intent of most countries in guaranteeing, extending or insuring credit is similar, practices and procedures differ widely. The Berne Union seeks to harmonize practice, standardize procedure and generally instil transparency.

A more confining constraint is found in the OECD Arrangement on Guidelines for Officially Supported Export Credits, the so-called Gentlemen's Agreement, for which the need became apparent in an era of floating exchange rates, volatile interest rates and competition for major projects in developing countries. Under the Guidelines, medium- and long-term credit extended by government agencies which goes beyond previously agreed interest rate floors and maturity limits must be notified beforehand and may be subject to consultation. Others are then free to match the offer and remove the advantage inherent in the offer and restore the elements of competition to such areas as quality, price and service. The object is to reduce subsidization of export credits to a minimum. The Guidelines differ for different kinds of facilities and

different kinds of beneficiaries, and are periodically reviewed to retain a close relationship to prevailing market conditions. In practice, the Guidelines have not prevented all abuses and are thus not a total constraint. Nevertheless, they provide a useful framework for limiting abuse and, as such, act as a constraint on Canadian practice.

A third constraining force is provided by GATT Articles VI and XVI and the Subsidies/Countervail Code. The GATT proscribes export subsidies on industrial products altogether and permits a variety of remedies to offset the injurious effect of domestic or production subsidies. In the list of prohibited export subsidies annexed to the Code, export credit subsidies which conform to the OECD Guidelines are specifically exempted from the general prohibition. National countervail legislation in the case of imports, or serious prejudice procedures in the case of competition in third-country markets, however, may be pursued by any country adversely affected by an export credit subsidy. This is true even when the subsidy conforms to the OECD Guidelines, as was done by the United States in the case of the sale of Canadian subway cars by Bombardier to the New York Transit Authority. The case was terminated for lack of a finding of injury caused to U.S. producers by imports of these subway cars, but only after the Import Administration of the U.S. Department of Commerce had determined the existence of a subsidy. The potential political wrath of New York taxpayers may have had a bearing on the decision to terminate proceedings for lack of injury.

Government Procurement

As governments have become more involved in the economy and their size has grown, purchases by government agencies have reached levels where they can play an important role in promoting industrial development. In Canada, purchases by the federal and provincial governments now amount to some $60 billion annually. Directing purchases by governments can thus have a powerful impact on particular firms, industries and regions and can be an important instrument of industrial strategy. Paying a premium to inefficient domestic producers, however, can constitute an irresponsible use of public funds, act as a subsidy, misallocate scarce resources and distort international trade. The GATT, nevertheless, specifically allows governments to discriminate in favour of domestic producers in purchasing goods and services for their own use.

Canadian governments, like those in other industrialized countries, have traditionally been prepared to pay a premium for domestic content, to discourage foreign tenders and generally to encourage the use of Canadian labour and materials to the point where auditors-general can always count on a horror story or two to spice up their annual reports. The pressure on both federal and provincial governments from domestic producers is not easily lessened by such examples. Government pur-

chases, where money has to be spent in any event, continue to be a relatively cheap form of subsidy.

By the 1970s, the distortion in international trade resulting from discriminatory government purchases had become apparent, as had the waste of scarce government resources. During the Tokyo Round, a first attempt was made to bring government purchasing more fully into conformity with the non-discriminatory principles of the GATT. The negotiations demonstrated the constant tension that exists between good politics and good economics. While every participant agreed other governments should open up their procurement and thus advantage their exporters, they also advanced good reasons to keep their own markets relatively closed. The result was a less ambitious agreement than had been envisaged originally. The 1979 Agreement on Government Procurement covers only purchases above a threshold level, approximately $220,000, because a lower level was considered impractical. Its discipline is limited to the specific national governmental entities named in the annexed schedules for each signatory. The negotiation of entity lists proved the most important aspect of the negotiations. It was conducted on a basis similar to a tariff negotiation, with each participant determining whether the opportunities afforded to its exporters balanced the possible inroads into its domestic market. Each schedule is subject to exceptions for particular signatories and any signatory may decide not to open up its procurement market to any particular signatory if it is not satisfied with that signatory's entity list. It thus does not satisfy the normal non-discrimination principles of the GATT. Nevertheless, it constitutes a significant step toward the liberalization of national procurement markets and provides a framework for the future expansion of its coverage. Negotiations are currently in preparation with that objective in mind.

Canada is a signatory to the Agreement and has applied its provisions since January 1, 1981. There remains, however, a reluctance on the part of ministers and government procurement officials to follow practices that fully subscribe to the Agreement's principles. While the administrative manuals and procedures have been revised in the light of the Agreement's requirements, the success of foreign tenders for sales for which foreign and Canadian suppliers can compete has been minimal. Publicly stated government objectives continue to stress that government procurement will be given greater attention as an industrial development tool and Canadian content continues to be a major criterion in assessing the bids of various tenders. For some purchases, foreign suppliers are systematically not asked to bid. As a result, less than one percent of the Canadian procurement market and less than five percent of the federal procurement market is covered by the Agreement, i.e., some $500 million annually. Little attention has been devoted by the federal government to apprising Canadian producers of new opportunities in foreign

markets opened by the operation of the Agreement. The few Canadian exporters who have ventured into the foreign procurement market have experienced similar resistance. The U.S. government, for example, through its minority and small-business set-aside programs, can effectively disadvantage foreign bidders. Nevertheless, the U.S. procurement market available to Canadian suppliers has been estimated at $25 billion annually.

As experience is gained with the Agreement, as exporters seek to exploit the foreign procurement market and register complaints, and as governments resort to the complaint and dispute settlement procedures, government purchasing should come into the mainstream of liberalized international trade. The scope for extending the coverage of the Agreement will to some extent be governed by the success experienced by exporters within the limited application now available.

For Canadian suppliers, the Agreement has reduced Canada's ability to use government purchasing as a tool for industrial development and has exposed them to greater international competition. At the same time, new opportunities have been created in previously closed markets and, in aggregate, these should more than offset any "losses" to foreign suppliers on the domestic market. Typically, however, the losers and winners will not be the same suppliers and there will thus need to be adjustment to this new situation.

Military procurement is not covered by the GATT Agreement. Canadian and U.S. military procurement is, however, covered by the Canada –U.S. Defence Production Sharing Arrangements. These arrangements, dating back to the 1941 Hyde Park Declaration, seek to maintain a balance between U.S. and Canadian production of military materiel and U.S. and Canadian purchases. As a result, the Canadian aerospace industry, for example, has benefited by becoming fully integrated into the supply networks of major U.S. aerospace companies. The arrangements have demonstrated the benefits flowing from more liberal trading conditions even for trade in sensitive products.

The Role of the Provinces

The development and implementation of Canadian positions on international economic issues have always been a process of reconciling conflicting interests in Canada. These conflicting interests are reflected not only in the context of the interdepartmental government structure at the federal level, but also in the private sector, where interests have always tended to be diverse, reflecting the way in which particular issues impinge on different groups. A new dimension is the growing involvement of provincial governments in international issues, and a parallel growth in their organizational capacity to insert themselves into the management of trade issues both at political and official levels. This

higher provincial profile on such issues has developed gradually over a period of years. However, it was probably the Tokyo Round trade negotiations that provided the catalyst for the growth of provincial government interest in, and capacity to demand, more direct involvement in the development of Canadian foreign economic policy positions. Another important factor is the increasing complexity and range of international rules and the tendency of trade negotiations to involve commitments which increasingly extend into areas of provincial jurisdiction.

The postwar prosperity and Canada's increasing involvement in international affairs coincided with a period of federal ascendancy and power. Recent doubts about the benefits of international rules and questions about Canada's place in the world, as well as the decline in economic growth, have coincided with a rise in provincial authority and particularism. The provinces now spend more money than the federal government, the growth in government involvement in the economy having been more striking at the provincial than at the federal level.

In the 1960s and 1970s, as Canadians began to look inward after the period of intense internationalism of the 1940s and 1950s, they looked inward as much as Quebeckers and Albertans as they did as Canadians. The growth in Canadian self-awareness, which has been described by some commentators as "nation building," has included a large element of "province building." Both nation building and province building have exhibited a marked protectionist dimension. But while federal actions have to some extent been conditioned by external factors and the international rules, this is less so for the provinces.

Provincial responsibility for industrial development has given rise to an understandable interest in interpreting this responsibility as giving them a legitimate interest in the conduct of trade policy. In addition, other provincial measures which affect the integrity of the Canadian common market and international trade include provincial control over agricultural and resource development, which in some cases has an impact parallel to export controls, provincial marketing boards, discriminatory procurement policies, and discriminatory tax policies.[33] Exclusive powers granted to the provinces by the BNA Act including, in particular, rights of taxation, and rights related to land, timber, mines and royalties can be said to provide legal cover for some of these provincial measures. In recent years, the provinces have become increasingly active in the development of resource and industrial policies. At the same time, the federal government has been seeking to develop policies at the national level in these areas. Inevitably there have been areas of overlapping policy thrusts, inconsistencies between federal and provincial approaches, and inconsistencies among the provincial authorities as well. There is thus an obvious need for federal-provincial cooperation within a framework that acknowledges the overall final responsibility on the part of the federal government. A few

examples will illustrate the kind of issues that frequently need to be addressed.

Not many years ago, the major U.S. automakers astutely managed to exploit federal-provincial and Canada–U.S. rivalries to extract major investment incentives out of both levels of government. By playing Ontario off against Quebec and Michigan, and Michigan off against Ontario and Ohio, they convinced various state and provincial authorities that the decision as to where to locate was in their hands. The federal government found itself in a no-win situation. If it failed to assist either Ontario or Quebec to develop a sufficiently rich incentives package, a new plant would end up in Michigan or Ohio. If it helped Ontario, Quebec would scream; if it helped Quebec, votes in Oshawa, Windsor or St. Thomas might evaporate. If it helped either province, the U.S. federal government would complain and might institute countervail procedures. In any event, funds were scarce. There was an obvious need here for federal-provincial cooperation and recourse to the international rules to avoid major political problems.

The Michelin tires and Saskatchewan glass beads countervail cases noted earlier afford another example of how provincial subsidy practices gave rise to the federal government's international obligations. The U.S. government countervailed not only federal regional development grants, but also various provincial financial assistance programs. The Nova Scotia and Saskatchewan governments were both disappointed that the federal government could not dissuade the U.S. government from imposing countervailing duties.

During the Tokyo Round tariff negotiations, Canadian distillers sought improved terms of access for their products into the U.S. and EC markets, especially a change in the discriminatory U.S. wine-gallon valuation system. Both the United States and the European Community indicated that any improved terms of access would require better access for their products into Canada, and especially a reduction in the discriminatory pricing practices of the provincial liquor boards. Both requirements were negotiated successfully. The United States abandoned its wine-gallon valuation system and both lowered duties on spirits. In return, the Canadian government convinced the provincial governments to enter into letters of intent spelling out that they would, over a period of years, reduce the element of discrimination in their pricing practices. While there have been difficulties in the past few years regarding the interpretation of provincial commitments, and while the federal government has had to act as a middleman between various provincial administrations and the United States and the European Community, these letters of intent marked the first time a matter of purely provincial administration was negotiated successfully in a multilateral trade negotiation. The scope for future negotiations is significant. Canada's ability to offer provincial procurement (worth some $40 billion annually) in a

future government procurement negotiation, for example, would add immeasurably to Canada's bargaining power.

The Tokyo Round marked an important stage in federal-provincial cooperation involving Canada's participation in the international trading system. In addition to the negotiation of provincial liquor pricing practices, the Tokyo Round included intensive formal consultations between the two levels of government on Canada's objectives in the negotiation. A number of provincial governments developed bureaucratic capacity to deal with international trade issues. During the 1970s, some of them also set up foreign offices to promote provincial exports, to provide intelligence on major developments in the United States, the European Community and Japan, and to liaise with foreign governments, to some extent by-passing federal responsibility for international trade and foreign affairs.

The stage has thus been reached at which provincial involvement in issues affected by the international trading system must be dealt with as a matter of course. Provincial governments want to be involved — indeed, they are demanding a voice in federal policy formulation that affects their interests. The federal government has been reluctant to encourage too much involvement, but hesitant first steps have been taken. A first federal-provincial trade ministers meeting was held June 21, 1982. More such meetings have been held since, with a view to joint consideration of issues of interest to the provinces, including trade relations issues, negotiating objectives and major developments in United States and offshore markets. Machinery has been developed at the official level to exchange information and coordinate positions. The government's trade policy review in 1982–83 involved extensive federal-provincial consultations, and the provinces jointly presented a detailed position paper which influenced the analysis and conclusions of the federal paper. In future, close cooperation will probably become an increasingly important dimension of federal policy making.

Although in particular instances it may be prudent to seek a consensus with provincial governments on particular trade issues, there are risks and disadvantages in requiring consensus as a general rule. For example, a consensus position which emerged on a particular issue might be different from a position based on a discrete assessment of the overall Canadian interest at the federal level. Equally important, any requirement for a consensus would tend to weaken both the responsibility and accountability of the federal government's constitutional authority over trade policy making. It is also relevant that a domestic decision-making process based on consensus between federal and provincial governments covering issues in international trade relations would be tantamount to inviting foreign governments as well as private sector interest groups to try to influence directly the views of provincial governments to the detriment of the national interest. Even if federal government author-

ity is in the final analysis protected, a process based on consensus would tend to constrain the exercise of this authority. It must, therefore, be emphasized that the federal government is more than an honest broker: it is the final arbiter of Canadian trade policy and the only actor capable of negotiating international agreements, even where the results of such negotiations may need to be enshrined in provincial law.

A further dimension to be considered is that of responsibility. If the provinces want greater involvement in Canadian participation in the international trading system, they will need to demonstrate a greater willingness to assume obligations and make concessions. Provincial administration of their commitments on liquor pricing practices is not likely to convince the United States and the European Community of the value of similar commitments on government procurement. Their eagerness to open offices abroad has raised concerns in some foreign capitals as to who speaks for Canada. The scope for petty politics is immense — and can be very destructive. While it is not difficult to undertstand why the provinces see value in becoming involved in federal trade policy making, an effective partnership will require that the flow of information, involvement and cooperation be reciprocal and include a clear understanding of the federal government's ultimate responsibility for the conduct of Canada's foreign trade relations.

The Canadian regions are vulnerable to the international economy in the same way that the national economy is, and individual provinces are typically more vulnerable because of a higher degree of regional specialization, such as British Columbia's dependence on the forest industry. The difference is that individual provinces can have different interests and, as a result of their differing natural resource endowments and industrial development, these interests can often conflict. In broad terms, however, up until now the provinces have accepted the need to act collectively through the federal government so as to enhance Canada's international negotiating leverage. In this way, Canada's vulnerability to the international economy and the pressures inherent in Canada's bilateral and multilateral relationships can be used to provide cement to Canadian national unity, as well as at the practical level to ensure sound management of the federal-provincial dialogue on international trade issues.

Constraints and Opportunities

The accent in this chapter has been on constraints on Canadian policy making that flows from obligations imposed by the international system. This is not unexpected. It is the issue of constraints that arises most frequently in considering and implementing various policies and programs. Unfortunately, however, this accent on the negative gives the impression that the benefits flowing from the international system are

few, and relate largely to the rather nebulous concept of maintaining the integrity of the system. The benefits, in fact, are more precise and real.

Trade and economic policy is largely about investment. Governments seek to improve access to foreign markets, protect their own markets, or create favourable economic conditions with a view to influencing future investment decisions. Favourable decisions thrive in an atmosphere of stability, predictability and transparency. The international system ensures that various actors in the system are similarly constrained and that, as a result, Canadian traders can be confident that their access to foreign markets is secure. That access was gained into markets much larger than Canada's through a process of multilateral negotiations which would have been difficult or impossible to achieve through a process of bilateral negotiations. Virtually all industrial tariffs of the industrialized countries are now bound at levels where they can no longer be considered, with some exceptions, to be major obstacles to traders. Furthermore, they are bound within a system designed to prevent countries from raising tariffs except under unusual circumstances and subject to agreed conditions. Non-tariff measures which can frustrate traders, such as artificially high values for duty, anti-dumping and countervailing duties, technical barriers, marking requirements, quantitative restrictions, buy-national practices and import licensing are increasingly governed by predictable and stable rules backed up by a reasonably effective system for settling disputes.

The benefit of secure access, however, is only as good as the practices of Canada's trading partners. The perception has developed in recent years that Canada is now alone in taking the rules seriously, that no one else is playing by the rules. This has become known as the boy scout syndrome. If this were true, it would be a serious matter. This perception, however, is not uniquely Canadian. Trade officials in the United States, Europe, Australia and elsewhere, indicate that their traders and politicians express similar frustrations. Undoubtedly, during a period of strong protectionist pressures, actual resort to protectionism is greater, and protectionism often involves measures inconsistent with the international rules.

Canada's record in this regard is probably neither worse nor better than that of its major trading partners. The Canadian tariff remains relatively higher than the tariffs of other OECD countries and Canadian resort to safeguard action, particularly for textiles and clothing, has been as extensive as that of its trading partners. The Canadian valuation and tariff nomenclature systems have long provided Canadian producers with an extra margin of protection. Canadian contingency protection instruments have been modernized so as to be as effective as those available to U.S. and EC producers. Canadian subsidy practices are extensive. While these measures are not in and of themselves inconsistent with the rules, they can be used to disadvantage importers and

frustrate access that others could reasonably expect. Generally speaking, therefore, it cannot be said that the Canadian market is more open than other markets. Whether true or not, however, the perception that Canada is the only pure member of the club has proved to be a convenient rationalization for resort to protectionist measures. The fact that everybody thinks their country alone is pure has to some extent undermined the consensus supporting the liberal trading system. It is a perception, however, which cannot be reversed by "others"; it must start at home.

The international rule of law differs significantly from domestic law. In domestic law there exists an independent authority to maintain the rule of law, find and punish offenders and intervene between disputants. In international law, enforcement is largely a matter of self-help and self-discipline. It is a system of mutually reinforcing rights and obligations designed to provide a balance of advantage to all participants. It is based on the concept of reciprocity, either conditional or unconditional. Failure to pursue rights, therefore, undermines support for obligations. Canadian participation in the system thus requires not only observance of the obligations, but also a vigorous pursuit of rights. A few examples will illustrate the importance of this two-pronged approach.

In the last few years, Canada has invoked GATT procedures involving the United States, Japan and the European Community to preserve access for tuna fish, spring assemblies for automatic transmissions, leather, and high-quality beef and newsprint. In all five cases, the United States, the EC or Japan had taken action, or failed to take action, inconsistent with their obligations. All five cases proceeded to panels, three of which reached conclusions favourable to Canadian interests, and one which was settled prior to the formal tabling of a panel report. The fifth did not find in Canada's favour. Similarly, Canada has recently withdrawn concessions from the United States in retaliation against U.S. failure to compensate Canada for restricting imports of Canadian specialty steel under a quota aimed at Japanese and European exports.

Canada's trading partners have similarly exercised their rights regarding Canadian measures considered inconsistent with Canada's GATT obligations. Both the European Community and the United States have successfully claimed compensation for Canadian safeguard measures. The European Community instituted dispute settlement procedures when Canada retaliated against it for its failure to improve access for lead and zinc as part of the settlement with Canada following U.K. accession into the Community. The United States took Canada to the GATT to obtain a ruling regarding certain FIRA procedures. In both cases, Canadian practice was partially vindicated and partially found inconsistent with GATT commitments. Similar findings would have been difficult to achieve in a one-to-one relationship.

Canada has not, however, always pursued its GATT rights. For years

Canada never exercised its rights under Article XIX when others took emergency safeguard measures adversely affecting Canadian exports. Canada failed, for example, to protect its access into the United States for uranium and for lead and zinc when the United States imposed restrictions inconsistent with its GATT obligations. Similarly, Canada has not vigorously pursued its rights regarding access rights for fish products into the European Community, leaving unchallenged EC preferences favouring Norway and its minimum price system.

The costs incurred by Canada for its failure consistently and expeditiously to pursue its rights, whether under the GATT or another bilateral or multilateral commitment, are underlined by two considerations:

- Canadian businessmen conclude that the government either will not or cannot preserve their access, which tends in some companies to reinforce the case for locating new production facilities in a larger market, and in others to increase pressure on the government to bend its obligations and increase protection or subsidize exports; and
- other countries conclude that they can adopt measures that impair Canada's rights and limit Canadian exports with impunity.

The arguments frequently deployed against invoking Canada's trade agreement rights relate to the desire to maintain good relations or to avoid jeopardizing a deal in the making, or to avoid the implication that measures taken by a country, once paid for, would stay in place indefinitely. These arguments deny one of the reasons why Canada pursued a multilateral system in the first place. That system reduces the disparities in power between Canada and its trading partners and allows Canada to influence, under a system of rules, the policies and practices of much larger entities. It is hard to find benefits accruing to Canada from restraint in pursuing its rights. Indeed, this attitude has added to the erosion of Canadian support for a strong liberal trading system.

The multilateral settlement of disputes allows both parties to find allies who have an interest in the broad principles involved. This is not possible in bilateral arbitration. The U.S. government took Canada to the GATT, for example, over the egg quotas established pursuant to the institution of the Canadian Egg Marketing Agency. The GATT established a Working Party, in which both Canada and the United States participated, that agreed that Canada had the right to establish a quota under Article XI; the United States gained a larger quota.

It is a truism that freedom requires structure. Without a framework to define the rules, there are no rules. Without rules, there is anarchy. In international relations, anarchy becomes a matter of naked power relationships where mutual consent is taken as the rule of law. A larger power is usually capable of convincing a weaker one that consent would be in its interest. In such a system there is no accountability and no responsibility, and such a system would not benefit Canada. In the next

two chapters, we will see how erosion of support for the multilateral rule of law has damaged Canadian interests, either by allowing actions which adversely affected Canadian exporters or by allowing Canada to avoid the need to adjust.

Chapter 5

The Particular Case of Safeguards

So beggaring my neighbour's trade
Is how the winning lobs are made,
It's simply not the game for fools
Who keep insisting on the rules.

— Bertie Ramsbottom
in *Anyone for Tennis?*

In trade and economic policy, the hardest choices often involve decisions to provide relief or respite from imports to beleaguered (and non-competitive) industries. These judgments are particularly difficult in times of recession. Safeguard actions to restrict competing imports often carry a heavy price for consumers and producers alike. Consumers pay unnecessarily high prices and producers, while attracted to such short-term palliatives, may only delay necessary adjustment and shifts in priorities and investment. Yet the pressures from producer interests are often so persuasive as to overcome these economic factors with relative ease. Governments have, therefore, entered into international commitments to provide a framework of rules to offset the pressure from narrow sectoral interests. This chapter seeks to describe in more detail the nature of these obligations, their likely future evolution, and their impact on Canada's economic development policies.

"Safeguards" in the commercial policy context is a term used to describe special measures of protection which governments can invoke in certain circumstances to regulate or intervene in the trade between countries when otherwise prohibited by bound concessions or the rules governing international trade. These can include a wide variety of measures such as those to safeguard the balance of payments, essential security interests, and health and safety, as well as special duties to

offset dumping or subsidization (the so-called unfair trade practices). For the purposes of this chapter, the term specifically refers to *emergency* safeguard action which may be taken to provide short-term protection for domestic producers who are faced with changing and unforeseen circumstances (but not including so-called unfair trade practices) which make them temporarily unable to compete with imports. Such measures in effect limit fair but politically intolerable imports. They are intended to provide a short-term respite during which producers adjust to the point where they can again face international competition under normal trade rules. The ability of governments to take such action is essential to gaining their support for bilateral or multilateral rules aimed at liberalizing world trading conditions.

Multilateral Rules

The basic multilateral rules governing the use of safeguards in the commercial policy context are to be found in Article XIX of the GATT. It was introduced by the United States during the 1946–48 negotiations and is a straightforward adaptation of the escape clause written into the 1942 U.S.–Mexico trade agreement.[34]

Article XIX provides that contracting parties may, in critical circumstances, impose import barriers to safeguard domestic producers for a limited period of time and on a non-discriminatory basis. In order to prevent abuse, it describes such circumstances, limits the type of action which can be taken and its duration and, most important, provides for consultation with interested contracting parties. If, following such consultations, agreement has not been reached on the need for and the nature and scope of the measure, affected contracting parties can resort to offsetting retaliatory action. The latter, in turn, is subject to disapproval by the contracting parties acting collectively. In such consultations, it is envisaged that the contracting party taking the measure can demonstrate that the product in question is being imported in increased quantities; that the increased imports are the result of unforeseen developments and of obligations under the GATT; and that the imports are entering in such quantities and under such circumstances as to cause or threaten serious injury to domestic producers of like or directly competitive products.

Specific Article XIX actions have taken a variety of forms including increases in bound tariffs, imposition of quantitative restrictions, surcharges, minimum values for duty, and tariff-rate quotas. Measures are meant to be taken on a non-discriminatory basis (but see below). The action should be no more restrictive than necessary to remedy the injury and should remain in force only as long as necessary to repair the damage and prevent recurrence. The discipline of consultations has been instrumental in enforcing these rules. While retaliatory action has been

infrequent, many consultations have been concluded only after the party taking the action has offered suitable compensation to restore the balance of concessions. Consultations should normally take place before the measure is implemented but as a practical matter usually take place immediately thereafter and until a mutually satisfactory settlement has been reached — often involving compensation, modification of the measure or understandings regarding its duration.

Discrimination and Market Disruption

From the outset, the most difficult aspect of Article XIX proved to be the need to apply the measure globally. While not explicitly stated in the text, the drafting history of Article XIX makes it clear that measures are meant to be non-discriminatory. Indeed, efforts to provide for discrimination by limiting action to the products of the supplying country or countries causing injury were specifically rejected.

The issue of discrimination first arose prominently in connection with Japan's accession when various suggestions were made to incorporate new provisions which would safeguard contracting parties from the injurious effect of so-called low-cost Japanese exports. Japan acceded in 1955 without any new general provisions being introduced. Individual contracting parties, however, invoked Article XXXV and the Protocol of Provisional Application to justify discrimination against Japanese exports.[35] Others discriminated without justification, or reached accommodation with Japan by the latter's agreeing to limit exports.

Of the various low-cost Japanese exports which most troubled contracting parties, cotton textiles held pride of place. As a result, various discriminatory quotas were put in place to protect the producers of other contracting parties from having to compete with their Japanese counterparts. These products were usually described as having an unfair advantage because of much lower labour costs in Japan and thus causing "market disruption." This new concept of market disruption was held to contain the following elements:

- the threat of increased imports from particular sources;
- the threat of imports at prices substantially below those prevailing in the market;
- a price differential unrelated to dumping or subsidization; and
- the threat of serious damage to domestic producers.

Market disruption thus went some way beyond the circumstances envisaged in Article XIX. Future recourse to Article XIX to prevent market disruption would go some way toward altering the balance of GATT concessions. The issues of market disruption and discrimination would grow in importance as imports from newly industrialized countries grew in prominence.

Special Rules for the Textile Trade

Uncomfortable with writing the concept of market disruption into the General Agreement, but troubled by the influx of low-cost cotton textiles from Japan and a few other low-cost sources, the United States sought an alternative means to deal with this problem. By the late 1950s, discriminatory and largely illegal quotas on cotton textiles were widely prevalent. The United States consequently proposed the negotiation of a separate instrument ancillary to the GATT which would sanction discriminatory quotas for cotton textiles but within an agreed set of rules. Special rules for textile trade were also an important ingredient in President Kennedy's development of a U.S. negotiating position for the trade negotiations that bear his name. The result was the Short-Term Arrangement Regarding International Trade in Cotton Textiles (STA) of 1961 followed by the Long-Term Arrangement Regarding International Trade in Cotton Textiles (LTA) of 1962.

While widely criticized as a regressive development, the LTA demonstrated the pragmatic nature of the GATT. A difficult problem had developed which, if left unchecked, would have gradually eroded the credibility of the GATT as an effective instrument providing stability, order and predictability in international trade relations. At the same time, many contracting parties could not for social and political reasons have allowed their cotton textile industries to be eliminated through import competition. The STA and LTA ensured a return to order and the rule of law in that trade, but limited to one sector the application of the new, less onerous safeguard rules. Pragmatic or not, however, a dangerous precedent had been set. Contracting parties agreed that they were prepared to provide institutional legitimacy for policies aimed at avoiding difficult adjustment problems.

The LTA came into force for five years on October 1, 1962 and was twice extended for three years. During this period, similar problems arose for other textile products made from wool and man-made fibres exported by an increasing number of low-cost suppliers. As a result, in 1973 the LTA was extensively renegotiated and transformed into the Arrangement Regarding International Trade in Textiles or the Multi-Fibre Arrangement (MFA). It entered into force January 1, 1974 and was extended for a four-year period in 1977 and in 1981 for a further period of four years and seven months to July 31, 1986.

The MFA exists, then, because the provisions of Article XIX did not prove sufficiently adaptable in a practical manner to the circumstances which characterize production and trade in textiles and clothing, including in particular political circumstances. Production costs of similar products vary widely between industrialized and developing countries, and shifts from one product line to another, as well as changes in the pattern of distribution in the international market, can take place

rapidly. Production threatened by low-cost imports often takes place in industrialized countries in disadvantaged and politically sensitive regions and typically uses low-skilled labour with few alternative employment opportunities.

The MFA, which was developed jointly by producers and consumers, permits trade to be restrained on a discriminatory basis by means of bilaterally negotiated export restraint arrangements. It guarantees the exporting countries certain minimum access, including year-to-year growth, to import markets of major economic significance. Instead of compensation, it offers exporting countries control of exports from which they gain economic rents. In short, it provides a framework of special international rules otherwise conflicting with GATT rules within which to manage one of the more politically difficult sectors of international trade.

Use of Article XIX Safeguards

In the nearly 40 years of GATT's existence, formal recourse to Article XIX has been relatively limited. Only some 115 instances had been recorded at the end of 1984 with the United States, Canada and Australia accounting for some two-thirds of these. In the early days, Article XIX action usually involved a tariff increase and was often taken prior to the renegotiation of bound tariffs under the procedures laid out in Article XXVIII which then restored the balance of concessions. Since the early 1960s the trend has been toward quantitative restrictions, itself an indication of the gradual decline of the tariff in general as an instrument of protection. Most measures have been of limited duration, some for as little as a few weeks. Some measures, however, were in place for extended periods of time, including a German requirement for the licensing of coal imports which has been in force since 1958. A number of U.S. measures were in force for up to 12 years (increased duties on glass from 1962–74; increased duties on carpets from 1962–73; and quotas on lead and zinc from 1958–65). In a number of cases agreement with interested parties required compensation (fewer than 20 cases have been reported, but it is widely known that compensation has been paid in other instances but not reported, including some Canadian cases), or some modification of the original measure, or the suspension of substantially equivalent concessions (only some six reported cases, the threat of retaliation often leading to satisfactory offers of compensation).

Safeguard Action Outside Article XIX

The above overview would seem to suggest relatively infrequent recourse to safeguard action by the GATT contracting parties — an average of only three a year. Such a conclusion, while factually correct,

would be misleading. As noted above, the widespread use of safeguard measures in the textile sector outside the discipline of Article XIX led to the establishment of a separate instrument with less onerous obligations more likely to be observed. Furthermore, many European countries used the provisions of Article XXXV as well as the Protocol of Provisional Application to maintain discriminatory quantitative restrictions, largely against imports from Japan, for an extended period and thus protected domestic producers from more competitive suppliers. Most of these have now been phased out. In addition, developing countries can use the provisions of Articles XII and XVIII to provide extensive protection to domestic industries under broad restrictive import policies designed to safeguard the balance of payments and economic development. As a result, developing countries rarely invoke Article XIX (only three recorded examples: by Nigeria, Peru and Israel). Finally, governments have resorted to measures which fall wholly outside the discipline of the GATT. The latter would include the range of measures introduced in the textile sector in the 1950s and again in the late 1960s and early 1970s and subsequently covered by the various textile arrangements, as well as a range of similar measures introduced more recently and applied to a wider range of products. Most prominent among these are so-called voluntary export restraint agreements and orderly marketing arrangements such as those exercised by Japan on its automobile exports.

In the past few years, the inability of major GATT contracting parties to deal adequately with two sets of problems within the existing rules has suggested to some that Article XIX may no longer provide an appropriate framework for safeguard action. The first set relates to structural problems in major domestic industries which give rise to pressures for protective action. The second set relates to extended periods of slow economic growth, again giving rise to protectionist pressures. Neither set of circumstances can be characterized as temporary, the result of unforeseen circumstances, or the result of an increased flow of imports resulting from GATT concessions. Resort to safeguard action in such instances, therefore, goes beyond the circumstances envisaged by the architects of Article XIX, whether the action taken falls within its discipline or not. Yet the need to take action can be persuasive, if not in economic terms, then in political or social terms. This has been the case now for several decades for the textiles and clothing sectors. Agriculture has always been considered a special case. In many countries during the past few years, competitive import pressures on the steel industry, the shipbuilding industry, the footwear industry and the automobile industry have been widespread, and governments have responded with a variety of measures, many of them outside the discipline of the GATT. This widespread phenomenon has in turn undermined the credibility of the GATT as an effective instrument for preserving order in international

trade relations. While individually continuing to take such safeguard measures as considered politically necessary (whether justified by GATT provisions or not), the GATT contracting parties have therefore collectively sought for more than a decade now a better set of rules to govern a wider range of safeguard situations and measures.

In searching for a more appropriate basis for safeguard action, the various textile arrangements have not been found suitable for duplication in other sectors. While considered necessary to manage trade in textiles, the MFA is recognized as a regressive instrument which has institutionalized and sanctioned widespread protectionism. Rather than aiding adjustment, it has frozen patterns of trade and thus retarded adjustment. The invidious nature of these arrangements is well demonstrated by the fact that each successive instrument has been more restrictive than its predecessor, responding to the continued pressures from the textile and garment industries in industrialized countries for ever more protection, resulting from the volatile nature of the trade and an inability to adjust to changing circumstances. The United States, the European Community, Canada, and the Nordics now all have comprehensive bilateral arrangements in place covering virtually all clothing and significant textile imports from developing and state-trading countries. OECD governments have so far resisted pressures from other industrial sectors severely affected by import competition to introduce similar import regimes justified by a similar framework agreement.

Injury, Adjustment and Protectionism

The principal objective of nearly 40 years of trade liberalization under the GATT (i.e., the reduction of tariff barriers and the regulation of non-tariff barriers) has been to encourage a more efficient allocation of resources on a worldwide basis and to bring order into international trade relations. The system was based on the assumption that the market is the best allocator of resources and that various measures which impede the market mechanism should be reduced — but within an ordered system. Re-introducing such barriers, even temporarily, thus could lead to a misallocation of resources. Yet the right to extend temporary safeguards has always been regarded as a prerequisite for the gradual adoption of generally liberal trade policies. In order to ensure that emergency protection does not revert gradually to permanent protection and defeat the continuation of liberalizing trade policies, two principles were built into the safeguard system: first, emergency protection should only be granted to producers *seriously* injured by imports which have increased suddenly as a result of a new concession; second, protection would be granted *temporarily*, i.e., only long enough to realize adjustment to the changed circumstances. In the past few years,

these principles have been much eroded. The relatively recent increase in protectionism has been characterized by a very broad interpretation of serious injury and by a failure to adjust.

Resistance to change has long been one of the underlying factors fuelling protectionism. The pattern is familiar. An industry, as a result of inadequate investment in new products and processes, finds its productivity growth slipping and its market position threatened by more competitive imports or technologically more advanced competitors. As the declining market share drives the domestic industry to lower its prices, profits fall and needed investment is delayed. The delay adds to further slippage in productivity and competitiveness.

In order to halt the spiral of decline, the industry petitions for import relief and mounts an intense lobbying campaign to convince its supporters in government that its survival is essential to national welfare and that "unfair" imports will drive it out of business. Its spokesmen are not interested in either the fine points of law and international obligation or in the best international division of labour and allocation of resources. They know that before import barriers were lowered, life was easier and profits higher. They thus seek import relief as a way out of this dilemma, not as a temporary respite during which they can adjust to new competitive forces. If the lobbying is intense enough, imports (while not found to be unfair, i.e., dumped or subsidized), are found to be seriously injurious.[36] As a result, the industry is entitled to and granted temporary import relief. Responding to this measure, the embattled industry rebounds and regains its market share. Profits are distributed to keep investors happy and major investment is further delayed. The industry claims that that kind of investment can only be made if it can count on a period of stability, i.e., on long-term protection. Thus the vicious pattern begins: adjustment is delayed and temporary becomes long-term. To get around the problem of serious injury, which is now no more than threatened, the so-called grey-area measures are substituted for global quotas or surcharges.

To every OECD government, this pattern has become depressingly familiar and stubbornly resistant to all attempts to break out of it. Footwear, motor vehicles, steel, agriculture, shipbuilding and, of course, textiles and clothing, are all obvious examples. All face massive structural problems, all are considered essential, all have failed to adjust or the policies supporting the sectors have outlived their usefulness as economic conditions have changed. Over time, temporary measures to induce adjustment have evolved into long-term measures to avoid adjustment. When an industry is guaranteed a market behind new protective barriers, the incentive to adjust is severely dulled. Little or insufficient adjustment takes place. This protectionism has induced new rigidities into markets, interfered with the movement of resources to more efficient uses, and reduced the potential for overall economic

growth. The sectoral interests also identify closely with the existing policy and make it difficult for governments to introduce policies to redress structural problems, market imbalance and lack of international competitiveness. Hence policy measures become partial, ignore broader benefits to the economy and tend to result in increases in the level of protection enjoyed by the sector. Such narrow sectoral policies in turn have broader implications for macroeconomic policies.[37]

As an alternative or complement to import relief, governments have begun to experiment with adjustment assistance. Government aid to industries is not new, of course. Indeed, competitive subsidization has long vied with the building of tariff walls as the chief villain of beggar-thy-neighbour policies. In the original GATT negotiations, tariffs were judged the lesser evil. Subsidies were banned; tariffs were to be dismantled gradually. Adjustment assistance, however, to help industry adjust to changing competitive circumstances resulting from trade liberalization is relatively new. The United States introduced this concept into its trade legislation in 1962, modelled on some earlier European experiments. Canada introduced similar programs to help gain industry acceptance of the Kennedy Round tariff cuts and later of the Tokyo Round. Nevertheless, adjustment assistance remains relatively untried, with economists arguing whether it offers a better solution or is, in practice, just another form of protectionism.

Government financial programs to induce adjustment, often with strings attached, have been criticized as unwarranted intervention by government in the economy. It is hard to take this criticism seriously. Once an industry has petitioned for import relief, it has already asked government to intervene. There is no a priori right to protection at the border. Government, however, may wish to consider the most appropriate instruments or combination of instruments it wishes to deploy in aid of a particular industry. While government planning and decision making may be second best to the decisions of the market, an industry petitioning for import relief has already decided that the market has failed.

The issue, then, is not whether to intervene, but how and to what degree. Unfortunately, adjustment assistance is considered to be more interventionist than import relief through border measures. Countries which are perceived to be more interventionist are more likely to be the targets of complaints from trading partners and subject to pressure from other governments who perceive their interests to be adversely affected. There appears to exist a bias, particularly in the United States, against overt adjustment assistance, even when it substitutes for import relief. The dispute between the United States and the European Community on their different approaches to the problems of their respective steel industries is a case in point.

Efforts by governments to induce adjustment of economic resources to more efficient uses have become a commonplace development.

Adjustment as a substitute for import relief could become a welcome alternative to the protectionism of the last decade and could facilitate movement toward more disciplined safeguard procedures. This will require, however, a measure of international understanding and cooperation. One government can easily frustrate the adjustment policy of another government by adopting countermeasures. It is to be hoped such developments can be kept to a minimum.

In pursuing adjustment policies as a substitute for or complement to import relief, governments can have two objectives in mind: policies which encourage the development of alternative economic activities, or policies which stimulate a return to international competitiveness. The first is politically difficult; the second is rarely successful. There seems to be a bias in favour of the second, which explains why there does not appear to have been sufficient adjustment and why there is a continuation of pressures for new or continued import relief. The bias against the first objective arises from the fear that alternative employment will not be found if the so-called sunset industries are allowed to die.[38] Failure to solve this problem, whether real or not, has made solving the safeguard problem much more difficult.

The Search for New Disciplines

Since the early 1970s, the GATT contracting parties have been engaged in protracted discussions and even negotiations to conclude a subsidiary safeguards agreement to the General Agreement. During the course of the Tokyo Round of multilateral trade negotiations (1973–79), major participants agreed that the existing provisions of Article XIX were generally adequate (a judgment which probably would not be made today and which has not been borne out by their individual actions) but that, because of differing interpretations and applications, it would be desirable to conclude an agreement which would clarify, interpret and elaborate the existing rules and procedures. This approach was consistent with the overall Tokyo Round approach to a range of non-tariff measures including anti-dumping and countervailing duties, customs valuation, licensing, and product standards. For all of these measures, efforts were directed toward a detailed construction of international law based on the general principles contained in the GATT, and elaborating and extending existing GATT rules. Despite intense preparations and negotiations, however, it did not prove possible to reach a safeguards agreement by the spring of 1979 when all other aspects of the Tokyo Round were concluded. The negotiators had developed an ambitious and comprehensive text which addressed the major preoccupations of most interested parties.[39] Political will to conclude an agreement was relatively high. Many LDC participants indicated that failure to conclude a

safeguards agreement would in their view constitute a failure of the Tokyo Round negotiations as a whole. The United States, Japan, the EC and Canada also attached considerable political importance to reaching agreement on this code.

Agreement, however, was not reached, largely because of a failure to agree on the issue of "selectivity" or discrimination, where the differences between the EC (backed by the Nordics) and the LDCs (with a measure of support from the United States, Japan, Canada and Australia) proved unbridgeable.[40] Despite this failure, the Tokyo Round did conclude successfully and safeguard measures continue to be implemented, but increasingly outside the discipline of Article XIX.

Since the spring of 1979, discussions have continued at a technical level and occasionally have been given a boost by renewed commitment at the political level. The GATT established a Committee on Safeguards to monitor ongoing informal consultations. Various new proposals have been circulated (by Switzerland, the Nordics and the United States), but none has attracted sufficient support to provide a basis for negotiation. The text developed during the Tokyo Round has been largely abandoned.

In 1981, the Committee on Safeguards decided that:

1. the provisions of Article XIX of the General Agreement continue to apply fully and at the present time the rules and procedures for their application remain unchanged;
2. the CONTRACTING PARTIES will continue to keep the matter under examination and discussion and to this end the Committee on Safeguards will expedite its work; and
3. all actions taken under Article XIX and, to the extent possible, other actions which serve the same purpose will be notified to the CONTRACTING PARTIES. In addition, it will be open to contracting parties to bring up any matter in accordance with the understanding regarding Notification, Consultation, Dispute Settlement and Surveillance.[41]

These conclusions reflect the assessment that a comprehensive agreement was not negotiable at that time and that efforts directed toward a lesser instrument, either on its own merits or as a transitional step toward a more comprehensive agreement, would be more realistic. Achievement of this goal, however, has also proved elusive. The differences which proved irreconcilable during the final stages of the Tokyo Round became even more intractable once pressure to conclude a major negotiation was removed. Furthermore, the increasing pressure for protectionist measures apparent during the period 1979–82 brought out in sharp relief the number of incompatible objectives being pursued by

various participants (e.g., transparency and discipline for the actions of others but freedom for one's own actions; the right to seek compensation but minimize payment; and the right to act selectively but not be discriminated against).

As a result of this lack of progress, the safeguard issue featured prominently in the agenda for the 1982 ministerial-level meeting of the GATT Contracting Parties. A survey undertaken by the secretariat prior to the Ministerial meeting revealed the existence of a large number of restrictive measures in place outside the discipline of the GATT and underlined the need to make some progress and find some basis for bringing such measures within the rule of law. It was widely held that a safeguards agreement which was fair and equitable and which placed effective discipline on the major trading nations would make a major contribution to resisting protectionism. The United States came armed with a draft text for consideration by ministers.

The results of the Ministerial session demonstrate how elusive a successful safeguard negotiation has become. Ministers agreed that there was urgent need for an improved safeguard system "to preserve the results of trade liberalization and avoid the proliferation of restrictive measures." Renewed efforts were to be made to arrive at a new understanding by the 1983 session of the contracting parties containing the following elements:

- transparency;
- coverage;
- objective criteria for action including the concept of serious injury or threat thereof;
- temporary nature, degressivity and structural adjustment;
- compensation and retaliation; and
- notification, consultation, multilateral surveillance and dispute settlement with particular reference to the role and functions of the Safeguards Committee.

The 1983 session came and went without any serious progress having been made.

Prospects for a New Safeguards Code

While the need for a new safeguards code remains paramount, the prospects for arriving at a broadly acceptable multilateral instrument are not good. The result of more than ten years of inconclusive negotiation, concurrent with undisciplined experimentation with various new forms of safeguard action, have seriously eroded confidence in the GATT safeguard system and at the same time have sanctioned, through unchallenged usage, discriminatory bilateral and even unilateral solutions. In addition, it is apparent that many of the safeguard actions taken

by various governments not only go beyond the discipline of the GATT, but also often lie outside domestic legal procedures.

The export restraints practised by Japan on its automobile exports to the United States and Canada operate similarly to a quantitative restriction on imports. It would not be possible to effect such import restrictions in the United States or Canada, however, either under existing domestic legislation or international procedures consistent with the GATT without a finding of serious injury. The International Trade Commission in the United States in 1980 specifically did *not* find that imports of automobiles from Japan were causing serious injury, a finding which would have permitted U.S. safeguard action. The United States then negotiated a voluntary export restraint arrangement with Japan. The Canadian government did not even seek an independent injury finding, moving immediately to negotiation of an export restraint.[42] Various European governments tightened up their import regimes, thus proving once again the domino theory of protectionism: as long as one major market insulates itself from the rigours of international competition, others will follow suit.

There exists no clear legislation in Canada providing a legal framework for the negotiation of export restraints substituting for import restrictions or even restrictions themselves where no serious injury exists. The U.S. requirement for action by the governments of the exporting countries relates to its formidable anti-trust legislation. Foreign exporters responding to U.S. government pressure are still liable to prosecution unless their governments acquiesce. Judgments whether or not to extend protection in such circumstances are thus wholly political, and procedures are often extra-legal. Furthermore, no formal agreements exist. After protracted secret negotiations, the Japanese Ministry of International Trade "forecasts" that Japanese exports to Canada or the United States are likely to be X, i.e., a number considered acceptable by the importing authorities. Historically, these forecasts have proved to be remarkably accurate. No other arrangements exist.

Similar difficulties in existing extra-legal safeguard procedures can be found for the EC and EFTA countries and to a lesser extent for Japan. Taken together, they bear eloquent testimony to the need for a new safeguards code which would provide a set of rules more attuned to current circumstances and more likely to be observed. Based on past experience, a successful negotiation would probably need to satisfy the following elements:

- attract broad support;
- cover all measures having a safeguard effect, but possibly excluding the textiles and agricultural sectors;
- provide adequate discipline while allowing sufficient scope for appropriate measures;

- provide for selective action by agreement between two or more parties but subject to prescribed conditions to protect the interests of third countries;
- allow affected parties to respond to seek redress;
- provide for adequate procedures covering notification, consultation and dispute settlement; and
- provide for effective multilateral surveillance.

Should such an agreement be negotiated, it would provide for effective discipline of members taking safeguard measures by requiring that:

- any measure be based on a defensible finding of serious injury;
- the measure be no more restrictive than necessary to eliminate the threat of serious injury or repair any damage caused by seriously injurious imports;
- the measure be in place no longer than necessary for the injured industry to adjust to new competitive conditions; if adjustment does not appear to be taking place, the measure should be withdrawn or converted to permanent protection following Article XXVIII procedures;
- the measure be accompanied by mandatory adjustment requirements and assistance to ensure an early return to normal conditions; and
- the member taking the measure offer adequate compensation and submit to multilateral scrutiny and consultation as to its compliance with the rules.

These objectives and this general approach to the elaboration of new rules are broadly shared. Translating them into precisely negotiated texts which adequately meet the interests of all major participants, however, has proved impossible. It is analogous to the dilemma faced by the original architects of the International Trade Organization, i.e., finding a way to attract the support of both the perfectionists and the protectionists. The former seek a system so foolproof as to be non-negotiable; the latter want so many loopholes as to negate the purpose of the arrangements. It is worth recalling that the ITO failed to come into being over this very issue.

The failure to date to negotiate a satisfactory safeguards agreement should be seen in terms of the difficulties of the issue itself as well as in terms of its being symptomatic of a larger problem. As has been noted earlier, the consensus that supported trade liberalization and the rule of law as important objectives of national and foreign policy has weakened significantly. The earlier postwar consensus relied on U.S. leadership, prestige and authority. It was apparent throughout the 1970s that changing comparative advantage and slower economic growth were not met with adjustment but with accommodation. Many of the policy measures of accommodation evaded the GATT system of rules and relationships.

Many governments assumed that the extra-legal measures they felt forced to take by domestic economic and political forces would be tolerated by their trading partners. Pleas for toleration multiplied and evasion of the rules became more general. The United States was not an exception in this process. While it was generally recognized that this was not a happy state of affairs, and that erosion of the system needed to be reversed, little action was taken to give meaning to the words. In this case, lack of action meant more than maintaining the status quo. Rather, it aided and abetted the erosion. Nowhere has this been clearer than in the case of safeguards.

The most frequently cited reason for the failure of negotiations has been EC intransigence on the issue of selectivity. The EC has to date been unwilling to accept meaningful discipline on the selective or discriminatory application of safeguards. It has taken the position that while a new code would be helpful, it no longer views itself as seeking a multilateral framework for selective application of safeguard measures. In the EC view, the onus is now on those who oppose current practice to propose alternative approaches. To date the LDCs, which oppose selective action most strongly, have not proposed any concrete suggestions for breaking this deadlock.

In understanding the position taken by the EC, it should be kept in mind that its attitudes are conditioned by the net of arrangements it has forged to complement the Treaty of Rome. The EFTA countries (Norway, Sweden, Finland, Austria, Switzerland and Portugal) are linked to the EC by means of free-trade agreements; the Mediterranean countries are linked through association agreements, a kind of membership-in-waiting; and the African, Carribbean and Pacific former colonies are linked by means of the Lomé Convention. As a result, more than half of the EC's external trade and many of its trading relationships are based on arrangements which stand outside the GATT (or at best enjoy a hesitant toleration under Article XXIV). Europe does not accord full GATT status to its eastern European trading partners.[43] Safeguard actions within the EC system are not governed by GATT Article XIX and probably would not be governed by a new safeguards agreement.

One other important EC trading partner also enjoys a special, although not preferred, status. Some years ago the EC finally agreed to lift its reservations under Article XXXV and to recognize the GATT as its trade agreement with Japan. In reaching this decision, the EC sought and received cooperation from Japan. In return for lifting its residual restrictions, the EC, outside the GATT framework, convinced Japan to continue to exercise self-restraint on a range of sensitive products, some of them quite specific: no more than 2,000 automobiles to be exported to Italy and no more than three percent of the French automobile market to be taken up by Japanese exports. By entering into such arrangements,

the EC headed off the potential need for safeguard action in this and other sectors.

For the EC, then, Article XIX of the GATT is regarded as necessary, primarily to justify safeguard measures affecting the United States and Canada for trade in industrialized products. A complicating factor is that the United States and Canada insist that Article XIX be applied on a non-discriminatory basis. The EC thus usually seeks to avoid its use. Furthermore, safeguard measures taken under the Treaty of Rome and its various association agreements, as well as with Japan, are not normally notified to the GATT and therefore do not form part of the GATT safeguard inventory. They would not form part of the factual background for building a new agreement. Thus, a large proportion of world trade falls outside the full discipline of the GATT and would not be affected by a new safeguard agreement.

While the above situation is factually correct, it does not tell the whole story. A significant breakthrough in the GATT safeguard discussion would result from a decision by Japan and a few major LDCs (Korea in particular) to refuse to restrain their exports. Since the early 1950s, Japan has seen benefit in voluntarily agreeing to restrain selected exports to those markets most vocal in expressing opposition. It has calculated that such measures are preferable to import measures over which it has no control. In addition, Japan has taken the view that such bilateral cooperation will shield it from external pressure to further open its own economy. While Japan may thus have acted in its own interests, it also has fuelled the growth of extra-legal safeguard measures and the breakdown of international discipline. It would have been preferable for Japan to have forced its trading partners to resort to import measures and then used GATT procedures, including retaliation, to protect its export interests. Unfortunately, there is no suggestion that Japan is moving toward this latter approach.

Finally, the LDCs would appear to have a large interest in the negotiation of a safeguards code. They frequently cite failure to negotiate such a code as symptomatic of the failure of the system as a whole. While this is in part rhetoric, it denotes the negative attitude of many LDCs toward full and active participation in the GATT system. Sir Eric Wyndham-White, the GATT's first executive secretary, wrote a decade ago: " . . . the GATT has been very lenient . . . in the consideration of applications for accession by developing countries. Indeed it has sometimes seemed to be operating a recruiting station rather than a screening operation. For these reasons there has been a vast overloading of the membership by countries . . . far from willing . . . to accept the obligations and disciplines which membership of GATT entails."[44] This unhappy state of affairs has been well demonstrated in the safeguard negotiations. LDCs have failed to generate any practical ideas which would further their interests, particularly in regard to selectivity. The suspicion arises that

many LDCs find the lack of a safeguards code a convenient failure to which attention must be directed but for which solutions must be avoided. From their perspective, tensions in the GATT system are not unhelpful if one wants something other than the GATT, such as a larger role for UNCTAD.

Overall, therefore, the chances of successfully concluding a safeguards code in the medium to near term appear slim. The question arises as to whether or not this harms Canadian interests and if so, what Canada can do about it. In addressing this issue, it is important to consider what Canadian interests may be served by a new safeguards code.

Canadian Legislation

Canada, like other industrialized nations, has found it necessary on occasion to take emergency safeguard measures to protect temporarily embattled industries. To this end, various legislative instruments have been introduced to provide new ways of limiting imports in response to Canadian producers.

Canadian legislation currently provides various ways in which safeguard action can be taken. Section 8 of the Customs Tariff Act permits the Governor-in-Council to impose a surtax on imports for a maximum of 180 days, pursuant to a report by the minister of finance that in his judgment goods are being imported into Canada under such conditions as to cause or threaten serious injury to Canadian producers of like or directly competitive goods. The surtax may be extended with the consent of both Houses of Parliament or following a finding of injury by either the Canadian Import Tribunal or the Textile and Clothing Board (TCB). The government may also choose to introduce tariff rate quotas (i.e., procedures which allow tariffs to increase once a specified quantity has been imported). Section 5 of the Export and Import Permits Act permits the Governor-in-Council, on the recommendation of the appropriate minister, to impose quotas on imports based on a finding by the Tribunal or the TCB that these imports are causing or threatening serious injury to Canadian producers. Similarly, the government may place products on the import control list for monitoring purposes based on a finding of injury or threat thereof by the Tribunal or the TCB. The 1982 Meat Import Law provides for limits on imports of fresh, chilled and frozen beef and veal whenever the government determines circumstances in both the domestic and world markets combined are likely to cause injury to domestic production.[45]

Safeguard measures that have a price effect (such as surcharges and minimum values for duty) are administered under the normal provisions of the Customs Act and the Customs Tariff Act once orders-in-council have been passed establishing the new rates of duty or the minimum

value for duty for a particular class of goods. Quantitative restrictions are effected through individual licenses which are administered by means of the Export and Import Permits Act. Once the government has decided to proceed with quantitative restrictions, orders-in-council are passed, placing the product in question on the Import Control List.

Various checks and balances have been built into the system to prevent abuse and too-frequent resort to safeguard measures. At any one time, there are always producers and workers who feel abused and disadvantaged by more competitive imports and who would welcome temporary respite from this competition. Problems experienced by such special interest groups may be either short term or enduring. Such problems may arise suddenly because of exchange rate shifts, oversupply of a commodity on world markets, or an economic recession with more severe short-term effects in some sectors than in others. On the other hand, they may result from long-term shifts in comparative advantage or failure to keep pace with technology or productivity improvements at home or in other countries. Government procedures seek to avoid resort to safeguard action for the second problem and limit it to the first. Quasi-independent boards such as the Canadian Import Tribunal and the Textiles and Clothing Board were designed to remove to the extent possible political factors in arriving at a decision. They make recommendations to the government after extensive public fact-finding hearings.

Canadian Practice

Canada has taken safeguard action over the years for a variety of products. Temporary and emergency surtaxes have been imposed on bicycles, polyester filament yarn, men's and boys' shirts, and certain sensitive horticultural products. Quotas (both global and country-specific) have been applied on a range of textile, clothing and footwear products. A special valuation provision was applied to the import of turkeys in the mid-1960s. Discussions with Japan have led to that country's exercising self-restraint since 1981 in the export of automobiles, a measure analogous to safeguard action, as it did in the late 1950s and early 1960s for exports to Canada of stainless steel flatware. The same situation existed for beef and veal with other suppliers in the late 1970s.

One sector for which safeguard action has become standard (rather than of a temporary or emergency nature) is textiles and clothing, despite very high levels of tariff protection. Canada negotiated five-year bilateral restraint arrangements with some 17 suppliers in 1981–82, the product coverage of which ranges from one or two items to virtually all textiles and clothing exported by these sources. As new disruptive suppliers are identified, new arrangements are negotiated to maintain the integrity of the system.

In horticultural trade, Canada has in the past experienced problems requiring short-term emergency safeguard action covering fresh cherries, strawberries, corn, potatoes, and peas. The problems arise out of the fact that the Canadian season for these products is slightly later than that in the United States, so that when the United States experiences a bumper crop, exporters will indulge in distress selling in mid- or late season at the time the Canadian crop is just coming on the market. Because the product is usually highly perishable, a surtax of only a few weeks duration is often sufficient to remedy the problem. Since 1979, a streamlined system for implementing surtaxes in these cross-border trade circumstances has been in effect. It was triggered for yellow onions in 1983. As well, Canada negotiated seasonal tariffs in 1979–80 under the discipline of GATT Article XXVIII as a longer-term solution to this problem.

Various economic arguments have been advanced suggesting that many of these measures and others requested but not implemented are regressive and inimical to Canada's long-term economic interests and amount to protectionism. The simplest economic argument against protectionism rests on the thesis that Canada's economic growth must come from gains in productivity and efficiency stimulated by domestic and international competition. Protectionism relieves the protected economic sector from the pressure to increase productivity and reduce costs. Ultimately, protectionism distorts the allocation of labour and capital to more productive activities and constrains the growth of the latter.

A related question is the allocation of the cost of sustaining uncompetitive economic activity to the economy. Border protection makes consumers of the product assume these costs.[46] Thus the costs of border protection for the construction machinery industry would largely be borne by the building industry. Protection for textile mills increases the costs of clothing manufacturers and makes it harder for them to compete. Protection on food or clothing or automobiles has the same regressive effect as a tax on consumption of these products. The regional distribution of these costs is often a problem in Canada, since producers and consumers are not typically located in the same regions of the country.

Interesting as these arguments are, they are not often persuasive in convincing politicians that they must forgo short-term political gain from protectionist action accommodating specific producer interests in favour of long-term economic gain in the interest of general consumers. While producers and their employees remember protection rejected, they do not often attribute long-term welfare gains to government policy. More persuasive arguments have been those arguments arising out of international obligations reflecting external pressures. Indeed, this is one of the reasons Canada has long supported the rule of law in interna-

tional trade relations. The rule of law is supported ultimately by the concept of defensive retaliation. Protectionist measures may result in retaliation, or the threat of retaliation (either within or outside GATT discipline) against Canadian exports by the foreign country whose exports are affected. The impact of such retaliation will fall upon particular Canadian regions and economic sectors rather than on taxpayers or consumers in general. For example, Japan might restrict its imports of western Canadian resource products, grains or east coast fish products. In the European market, forest products, metals and minerals would be vulnerable to retaliation. The United States could respond to protectionist measures taken by Canada in virtually every economic sector, but Canadian exports of manufactured goods such as automobiles, transportation equipment and aerospace equipment would be particularly exposed.

Canada is especially vulnerable to such retaliation, especially by its larger trading partners, for two reasons. One is the fact that fully half of the goods produced in Canada (about one quarter of GNP) are exported, so that the loss of particular export markets may have significant macroeconomic impact; Japan, the United States and the EC are much less vulnerable because they export a much smaller proportion of their production and because the Canadian market is of lesser importance to them. Canada's relative external economic exposure is at least three times as large as that of the United States, the EC and Japan taken individually. Second, the Canadian is small by international standards, so that loss of access to foreign markets would deny economies of scale to affected Canadian exporters, with consequent cost increases and loss of opportunities to increase productivity.

It is also worth recalling that, as an exporter, Canada is vulnerable to the safeguard actions taken by others, including those largely aimed at others. Canada's ability to influence its trading partners to behave responsibly is directly influenced by the responsibility of its own actions. While often characterized as a boy scout argument, it is nevertheless true. In international trade, there are only exporters and importers, each vulnerable to the actions of the other, and each seeking to protect its interests.

Canadian interests have thus been served through the progressive development of international rules and procedures which seek to ensure that safeguard action and retaliation are governed by acceptable standards of international behaviour. Canada has taken various safeguard actions and has either paid compensation to affected trading partners or suffered retaliation. For the various horticultural safeguard measures mentioned above, the United States exacted compensation and ensured that the measures were of limited duration and applied infrequently. For various textile, clothing and footwear measures taken under Article XIX, compensation was paid to the United States and the European

Community. To protect its export interests, Canada has in recent years begun the practice of more aggressively pursuing its consultation rights and seeking compensation. The continuation of this practice will help to strengthen the system of international rules.

With one exception, Canadian safeguard practice does not include an overt or mandatory linkage between safeguard measures and adjustment measures. The exception is for the textile and clothing sector. Since 1970, the Textile and Clothing Board, in considering the need for protection and before recommending import relief, must take account of the viability of producer plans to adjust and the likelihood that adjustment will restore the industry to an internationally competitive position. Since 1981, the Canadian Industrial Renewal Board has existed directly to deliver adjustment programs linked to the relief measures implemented for the textile, clothing and footwear industries. There are no similar requirements in the general import relief legislation, nor was such a requirement contemplated in the new Canadian Import Measures Act.

In the United States import relief, since the 1962 Trade Expansion Act, has been linked directly to the provision of adjustment assistance.[47] The Administration, in considering a request for import relief, and the International Trade Commission, in considering whether imports are a substantial cause of serious injury to domestic producers, must from the outset determine whether the injured industry can eventually become competitive again and whether import relief and/or adjustment assistance would assist in making them competitive. Adjustment assistance, therefore, is a consideration required in law. The provision of such assistance can either supplement or substitute for import relief. This provision has been instrumental in reducing the number of instances where import relief has been granted. It is unfortunate that a similar provision was not included in the revised Canadian safeguard procedures recently adopted by Parliament. An amendment to this effect, even at this stage, would be an important and useful improvement in the legislation.

Canadian Interest in a New Safeguards Code

Failure to negotiate a safeguards code, coupled with the proliferation of extra-legal procedures and measures, has eroded confidence in the multilateral rule of law. As a trading nation, Canada benefits from stability and predictability in the multilateral trading order, and the growth of chaos and disorder would thus seem to harm Canadian interests. For two generations Canadian governments have concluded, as did the recent trade policy review, that " . . . the existence of the GATT has mitigated a 'rule of the jungle' in international trade and the domination of crude power relationships to resolve disputes."[48] To the extent that failure to conclude a safeguards system undermines the GATT system, it

would appear to be in Canada's interest to ensure that negotiations move in a more positive direction. So much for the general.

At a more particular level, a new safeguards code would:

- provide the basis for any safeguard action Canada may need to take;
- provide the basis for Canada to respond to safeguard measures by its trading partners which affect its export interests; and
- provide the basis for managing the trade relations implications of Canadian safeguard measures.

These purposes are now served by Article XIX. There is some question whether Article XIX does so effectively.

Canadian experience with respect to Article XIX suggests that in general there is adequate scope under existing rules to act quickly and effectively to provide Canadian producers with emergency relief from injurious imports. There are, however, constraints on the detailed approaches, some imposed by Article XIX, some by our own procedures. With respect to managing our trade relations and defending our export interests affected by safeguard measures, disagreements can be expected to arise with our trading partners to the extent that there are differing interpretations of rights and obligations under Article XIX. Such differing interpretations have increasingly arisen regarding such factors as consultation procedures, duration, degressivity, selectivity, dispute settlement, compensation, and retaliation. Should a new safeguards code lead to clarification of procedures, rights and obligations in these areas, it would constitute an improvement over Article XIX. Such agreement is more likely to be achieved multilaterally than on an ad hoc bilateral basis.

As existed for textile trade a generation ago, there now exists more generally a widespread belief that Article XIX is not sufficiently flexible to meet the difficulties imposed on governments by major structural changes in the economy and slow economic growth. A more flexible instrument would help governments to design and implement measures which respond to domestic pressures but to do so within an accepted code of international behaviour. Failure to construct such a code would not prevent such measures from being implemented — as has already been widely done — but would prevent them from being contained within an acceptable standard of behaviour. When law and practice bear no relationship to each other, it is necessary to change one. It appears easier in this instance to change the law.

It should be noted that while governments find it difficult to resist protectionist pressures, it is easier to do so if there exists a framework of laws, both domestic and international, which places limits on the freedom of governments to act arbitrarily. It is easier to explain to the executives of an embattled industry that they cannot be further protected for legal or international relations reasons than to explain that

their case has no merit or that they are uncompetitive. From a Canadian perspective, it is worth stressing that the GATT provides the trade agreement to govern trade relations with our major trading partners and that an effective GATT acts as the major discipline on the procedures of our most important trading partners, particularly the United States.

Finally, Article XIX does not provide for an effective system of multilateral surveillance. This failure explains why it has been so easy to evade its discipline. Measures are taken which cannot fit its discipline — but which are never notified and thus cannot be scrutinized except by those most directly affected. An effective surveillance system would go a long way toward overcoming the difficulties which have arisen in international safeguard practice.

In sum, it would appear to be in Canada's interest to encourage the process of negotiating a new safeguards code, both in general terms to strengthen the international rule of law and in particular to better manage Canadian safeguard policy. What, then, can Canada do to help the process along?

Some Suggestions for Moving Negotiations Along

It appears probable that the ongoing discussions in Geneva will not yield early results. There are too many players involved who do not see compelling interests served by a new code. Such a state of affairs is less alarming than frequently suggested. On difficult issues, it is hard to forge consensus when there are over 100 players around the table. Even 20 players need a large table and much flexibility. A common denominator among over 100 players is also not likely to satisfy many. During the negotiations which established the GATT in 1946–48, there were 23 — but one player clearly dominated and provided leadership. The GATT grew out of U.S. leadership and out of U.S. bilateral negotiations based on the 1934 Reciprocal Trade Agreements Act. Today U.S. leadership is not enough; but it is a start. Canada can help the process by working with the United States to help build a first and limited consensus.

Bilateral negotiations looking toward eventual multilateral commitments are a proven technique. In the past few years, Canada and the United States successfully negotiated an understanding relating to safeguard procedures on measures taken by the one which affect the other. It was not an ambitious negotiation. It grew out of difficulties encountered in reaching agreement in the late 1970s on a range of safeguard measures as envisaged in Article XIX: 3(a).[49] The Agreement was signed February 17, 1984. It should provide for improved procedures and disciplines. There is no reason why Canada and the United States cannot seek similar understandings with other interested trading partners, or why such understandings cannot be broadened in scope and in application. Such a process could facilitate the eventual negotiation of a more com-

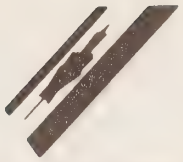
prehensive multilateral instrument. It should not be seen, however, as a substitute for a broadly based multilateral agreement.

There is another step Canada can take, either alone or in concert with others, particularly the United States. This would be to call Japan to account for its trade policy. A decision by Japan to say no to a request for extra-legal safeguard action would constitute an important contribution to the safeguard negotiations. Japan's right to say yes or no is not absolute. As a signatory to the GATT, it entered into an obligation to deal with its trading partners within a multilateral framework. Failure to do so, and instituting actions bilaterally which have an impact on the trade of others but which are not multilaterally scrutinized, can be considered to constitute nullification and impairment. For example, in agreeing to limit its shipment of motor vehicles to European markets a decade ago, Japan affected Canadian and U.S. interests in a number of ways. In the first place, it extended a concession to Europe in the sense of Article I:1 of the GATT which should have been made immediately available to all. This was not done. Secondly, by restraining exports to Europe, it distorted normal trade patterns and diverted motor vehicles to North America. Eventually, the United States and Canada sought similar deals. It would have been healthier for the trading system if the United States and Canada had invoked Article XXIII.[50] They can still do so now — in regard to Japan's automobile restraints and a host of similar measures. Such an approach would force Japan to deal with its trading partners within the GATT, rather than bilaterally. Such a state of affairs would benefit the trading system and would contribute to a move toward the negotiation of a safeguards agreement.

There is a third course of action available to Canada and its trading partners. If we genuinely want the rule of law to operate, if we believe the GATT system needs strengthening, and if we believe a new safeguards code is of positive benefit, we should live as if the rule of law does operate, as if the GATT is being strengthened, and as if a safeguards code is of benefit. Many years ago, the comic strip *Pogo* provided its famous insight into the human condition when Pogo announced that "We have met the enemy, and they is us." The GATT does not exist as an independent institution; it is the collective will of its contracting parties. Canada is one of the important and influential parties. If Canada wishes to strengthen the GATT, it can begin with its own trade and industrial policies. There is some question in recent years whether this has been the case. Aside from problems in the textile and clothing sector, Canadian measures affecting, for example, imports of motor vehicles and footwear have followed neither domestic nor international legal procedures. They are symptomatic of growing cynicism in our international trade relations. Such short-sightedness has undermined Canada's long-term trade interests. A reversal in attitude, exemplified by a lifting of restrictions on motor vehicles and footwear, could contribute to

improved trade relations and a strengthening of the rule of international law. It is in Canada's interests, since the country is so heavily dependent upon trade for economic prosperity, to ensure compliance with multilateral rules as well as ensuring transparency of domestic actions.

Chapter 6



The Particular Case of Textiles and Clothing

Well, that's life.
Sometimes results —
other times consequences.
— Andy Capp

The problems of trade in textiles and clothing have over the years demonstrated the difficulties that develop when safeguard measures are used as a substitute for structural adjustment. The Multi-Fibre Arrangement (MFA)[51] and the import policies pursued by all industrialized countries attest eloquently to the fact that long-term protection is not likely to lead to adjustment but rather to increasing rigidity in trade and production patterns and continued slippage in comparative advantage. Such a situation makes it necessary to tighten protection further and makes it more difficult to return to a competitive market situation. Yet in an interdependent world, few countries by themselves can change this vicious pattern. Resolving the problem requires concerted action and broad consensus. For a quarter-century, however, the consensus among industrialized countries has favoured a pattern of managed trade over competition, of protection over adjustment.

The rapid establishment of a sophisticated, growing, export-oriented textile industry in some 25 to 30 developing and state-trading countries during the past two decades has thus created a policy dilemma for Canada (as well as other industrialized countries). These countries produce fairly standard consumer items aimed at the lower to middle range of the market, i.e., right at the utility items which form the bulk of consumption and which are most sensitive to price competition, at prices appreciably below those charged by domestic producers and thus not greatly affected by the tariff. Domestic industries have been forced to

meet stiff import competition and have countered with increasing pressure on governments for measures to limit the entry of such low-cost imports. Governments have faced the difficult task of determining and applying commercial and other policy instruments at their disposal in order to maintain the viability of a mature or "soft" industry which has limited advantages and an increasing number of disadvantages. Without some form of help, a significant proportion of the industry, especially in the clothing sector, would rapidly fall victim to import competition and present governments with undesirable political, economic and social problems. Collectively, governments have gradually fallen prey to the current protectionist situation, and resolution of the problem is only possible through collective action. Interdependence also has disadvantages.[52]

The Origin of the Problem

Like food and shelter, clothing is traditionally considered to be an essential human need and is usually one of the first manufacturing industries to be established and developed in any country. The Industrial Revolution in Western Europe, for example, began with the mechanization and expansion of the cotton and wool industries. In more recent years, the textile industry has proved to be a catalytic factor in inducing and fostering economic growth and industrial development in a large number of developing countries, especially in Asia. It is a relatively simple matter to substitute locally produced textiles and clothing for imported goods and thus save foreign exchange for other essential goods and services. Rapidly thereafter, excess production can be exported to earn foreign exchange for essential imports. Most industrial processes in this industry are relatively simple and labour-intensive, and use readily available raw materials; they are thus ideally suited to the level of sophistication of most LDC economies. To induce industrialization further, off-shore entrepreneurs are encouraged to take advantage of the large pool of available low-cost labour and the various fiscal and other incentives offered by governments to new and export-oriented industries.

As a result, a significant proportion of the industrial labour force in a large number of LDCs is employed in the textile industry. For a smaller number of these so-called low-cost countries, the export of textile and clothing products has become the major source of much needed foreign exchange, and their companies enjoy the advantages of the most sophisticated machinery, management and processes. In many instances their export-oriented sectors are organized to generate export earnings and benefit from generous government subsidies. The importance of the textile and clothing industry to LDCs is illustrated by the fact that nearly

half of Canada's imports of end-products from LDCs are made up of clothing products.

The textile and clothing industry, however, continues to be one of the most important branches of manufacturing in all areas of the world. Even though the percentage of industrial workers employed in this industry is much smaller in industrialized countries, it still ranges from a low of 4–5 percent in Norway to a high of 11–12 percent in Austria, with most countries falling in the 6–10 percent range. Textiles and clothing account for some 10 percent of total value added in world manufacturing.

As a result of the above two factors, total world production of textiles and clothing has grown substantially in the last three decades. The growth in capacity has been fuelled by major technological improvements which have increased the productivity of both labour and capital. Most of this growth in capacity has been absorbed by growing demand, but not without creating problems and dislocation in the conduct of international trade.

The GATT safeguard system is based on the belief that governments will adhere to trade liberalization only if they can provide temporary, emergency relief from imports while a domestic industry adjusts and restructures to meet new competitive conditions. Safeguard measures are thus not meant to shield permanently the labour-intensive, low-technology industries from import competition. The textile and clothing industry's problems do not fit the normal criteria of the GATT safeguard system. From the mid-1950s on, in order to protect their domestic industries from excessive disruption by imports, industrialized countries resorted to a wide variety of both tariff and non-tariff barriers to limit imports. Some of these fell within the international trade rules of the GATT. A significant number, however, originally placed great strains on the GATT rules. Governments consequently entered into the special rules of the MFA.

The textile and clothing industries in industrialized countries have modernized and rationalized to some extent in order to meet competition from imports and compete for scarce capital, resources and skilled labour. But imports from low-cost sources have taken over an increasing proportion of the market. The speed of this adjustment process, moreover, has been influenced in large part by the overall health of the economy rather than by the degree of protection provided, e.g., there was relatively more investment in modernization in the 1960s than in the late 1970s and early 1980s. In most countries, governmental adjustment measures assist industry generally. These measures, aimed at improving efficiency through reorganization, rationalization, relocation of plant, technical research and the retraining of workers, are also available to the textile industry. Such programs can be instrumental in helping companies to take advantage of technological sophistication and to specialize in more profitable lines of production. In most cases, however, the

programs are aimed at modernizing the industry within the country concerned; rarely are they aimed specifically at phasing out a non-productive and inefficient sector and allowing it to transfer to a low-cost country. Governments find themselves ill-equipped to take on such a mandate. In fact, in most cases where production facilities are closed down in an industrialized country and relocated in a low-cost country, it is not the result of government policy, but rather of action taken by a multinational company reacting to market forces and seeking to maximize its profits.

As a result of rapidly changing technology, the industry has increasingly assumed the role of a multi-fibre and multi-process industry. In the last decade, man-made fibres have come into their own, ending the industry's original dependence on the principal natural fibres (cotton, wool, linen, silk and jute). Man-made fibres have introduced a wholly new and sophisticated technology into the industry. This, coupled with other technological advances, has made some parts of the industry somewhat less labour-intensive and more capital-intensive than they were in the not too distant past. Indeed, the problems now faced by the primary fibre and fabric sectors of the industry are often very different from those faced by the apparel sector. The primary sector is technologically efficient and tends to be capital-intensive, while the apparel sector still relies on older processes and tends to be labour-intensive. In Canada, the primary sector is at a disadvantage because high tariff barriers in other markets force it to concentrate on the domestic market for which it must, therefore, produce too many product lines to take advantage of economies of scale. The recent federal initiative examining the possibility of reducing barriers to the U.S. market is in part aimed at this problem. The labour-intensive apparel industry cannot readily compete with low-cost, off-shore competitors, sometimes as a result of government policies aimed at other problems. The indexed minimum wage in Quebec, for example, has helped to make the Canadian clothing worker one of the best paid in the world while, at the same time, it has made the industry increasingly less competitive. Nevertheless, the average wage in the textile and clothing industry is significantly below the general industrial average.

Despite limited adjustment, therefore, the textile and clothing industries have remained relatively prone to injury from import competition. The governments of most industrialized countries cannot question, however, for social and political reasons, the long-term economic viability of many parts of their domestic textile industries. Rather than leading to the progressive international rationalization of the textile industries, the MFA safeguard system has thus provided a framework allowing governments to pursue industrial and commercial policies which have tended to perpetuate the existence of a low-cost textile import problem for the industrialized economies. The pressure from low-cost suppliers, there-

fore, will probably continue and may even increase. The number of low-cost countries capable of producing large amounts of apparel for export is growing. Many low-cost countries, especially in Asia, have based large parts of their development plans on the production of labour-intensive consumer products for export to the major industrialized markets. In addition, the countries of eastern Europe, in order to purchase essential food and raw materials with convertible currencies, must export labour-intensive products such as clothing to the West without reference to costs. In order to encourage the establishment and growth of these industries, both developing countries and those with centrally planned economies provide generous subsidies and other preferential treatment, often tied to the industry's export performance.

Canada's Early Response

In the 1950s and early 1960s, the major source of low-cost textile imports was Japan. In order to manage these imports, Canada, as well as other major importers, concluded arrangements with Japan by which it "voluntarily" restrained its exports of certain sensitive products to Canada. In 1960, in response to the growth in low-cost imports and to the increase in the number of sources, the government established a senior interdepartmental committee to consider particular low-cost import problems and to make recommendations for specific relief measures to the minister of finance. The establishment of this committee (the Interdepartmental Committee on Low-cost Imports) coincided with the successful conclusion under the auspices of the GATT of a special arrangement to deal with this problem on a world scale (the Long-Term Cotton Textiles Arrangement). During the 1960s, the government negotiated a number of export restraint arrangements on specific products with a variety of low-cost suppliers (e.g., Japan in 1960, Taiwan in 1963, Hong Kong in 1965).

By 1969, as a result of the mounting pressures on the Canadian market from low-cost countries, this piecemeal approach was found to be unsatisfactory, and in 1970 the government introduced an integrated and comprehensive National Textile Policy. The aims of the policy were to provide a sense of direction and to create a framework and conditions within which the textile and clothing industries could plan, invest and develop with a greater degree of confidence. It was based on consideration of the following factors: the contribution of the industry to the Canadian economy; the need for employment stability; the regional and local implications; the interests of the consumer; Canadian export trade; and Canada's international obligations.

Having considered these factors, the government concluded that it should create conditions in which the Canadian textile and clothing industries could move toward viable lines of production on an increasingly competitive basis internationally. Without making any ad-

vance commitments, the government indicated it would be prepared to implement the following policy measures when and if necessary:

- rationalization of the textile tariff;
- improved methods for, and more effective use of, anti-dumping and countervail legislation;
- improvements in the Customs Act and Statistics Act in order to provide government with better and more current information on the flow of imports;
- measures of protection against "low-cost" imports if and when there was a formal determination of serious injury or the threat of injury and the industry concerned submitted appropriate plans to improve its competitive position vis-à-vis these imports;
- establishment of a Textile and Clothing Board to determine if the above conditions had been met and to recommend appropriate action;
- improvement in, and development of, further financial support measures to help the industry to become more efficient and competitive and to alleviate the social costs of dislocation caused by rationalization; and
- establishment of technical and promotional support measures including Development and Productivity Centres, a fashion/design assistance program and various promotional activities.

Although not all aspects of the textile policy were implemented as announced (and some were never implemented), it soon became clear that whatever was done in other areas, the crucial element in the policy revolved around the measures used to control imports.

A central feature of the policy was the establishment of the Textile and Clothing Board (TCB) as an independent body responsible for enquiries into situations involving possible injury to Canadian companies and workers. It would in the first instance review the situation and make recommendations to the government. The criteria for controlling imports which were to bind the considerations of the TCB and the government's implementation of TCB recommendations were to be the following:

- the relevant manpower and regional considerations and any program or service provided by a department or agency of the government;
- the provisions of the GATT and MFA and of any relevant international agreement;
- the probable effect of any proposed special measures of protection on various classes of consumers;
- the principle that special measures of protection were not to be implemented for the purpose of encouraging the maintenance of lines of production that have no prospects of becoming competitive; and

- the conditions prevailing in international trade relevant to textile and clothing goods.

During the course of its first six years, the TCB studied and recommended specific action on a variety of primary textile, fabric and clothing products. The government implemented many of these recommendations. The approach was on the whole selective and limited to those products from specific sources which the TCB considered to have caused injury to domestic producers. As a result, overall import penetration, especially from low-cost sources, steadily increased. Between 1961 and 1976 imports of clothing, for example, increased by 350 percent (from 86.5 to 391.5 million pieces).

Prior to 1975, the majority of import actions were aimed at protecting the primary textile industry. Most low-cost imported clothing tended to supply the low end of the market, which most domestic producers were prepared to abandon. Further, the primary textile industry, through the Canadian Textile Institute, was able to lobby the government more effectively for protective action. Indeed, the clothing industry, which was highly fragmented, frequently called for a more liberal trade policy so that it could gain greater access to low-cost fabrics. The increasing sophistication and productivity of low-cost apparel producers in the 1970s, however, led to increasing demands for protection not only from the clothing sector, but also from the primary sector which, without a healthy domestic clothing industry, loses a large share of its market. The increasing pressures on the government for more effective protective action had already led to a number of global quotas or surcharges under Article XIX of the GATT (rather than the selective approach of the MFA) on men's and boys' shirts, work gloves, double-knit fabrics, acrylic yarns and polyester filament yarns.

The 1976 Crisis

In 1976, imports of clothing increased by a further 46 percent over 1975. By late 1976, the share of the Canadian market held by domestic producers had slipped from 73 percent in 1971 to 55 percent (volume terms), and employment in the clothing industry had declined during the same period by 20,000 workers while in the primary textile sector the loss of employment was a further 12,000 jobs. The Textiles and Clothing Board, which in mid-1976 had instituted an enquiry into the clothing industry, concluded in an interim report in October 1976 that clothing in a wide range of types was being imported into Canada in such increased quantities and under such conditions as to cause serious injury to domestic producers. As a result, the government undertook to restrain imports of clothing to 1975 levels and provide the industry with a level of protection

it had long demanded. Three factors were especially relevant in this decision:

- other industrialized countries, especially those in the EC and the United States, practised much more restrictive textile import policies than Canada. Pressure on the Canadian market was, therefore, proportionately larger than it would have been if the world market as a whole had been more open;
- growth in worldwide capacity, in both industrialized and developing countries, had by 1976 far outstripped growth in worldwide demand, threatening to expose the Canadian market at a time of recession to disruptive imports from all sources, not only low-cost sources; and
- the concentration of employment in textiles in Quebec and eastern Ontario, i.e., in areas of high unemployment and political sensitivity, made it all the more imperative for the government to intervene and provide the industry with some breathing room to adjust to new competitive conditions.

The government initially chose to use the emergency safeguard provisions of Article XIX of the GATT and on November 29, 1976, announced a temporary global quota on all clothing. The government adopted this approach largely in order to ensure immediate relief and to roll back imports to 1975 levels. Action under the MFA would have required extensive and time-consuming negotiations, would not have afforded the level of relief considered desirable, and the results would have been less predictable.

Resort to Article XIX of the GATT rather than the MFA, while providing immediate relief, did have some major disadvantages. The members of the GATT Textiles Committee, which met soon after the imposition of the global quota, severely criticized Canada. Specific criticisms included:

- Canada had resorted to the general safeguard provision of the GATT before having fully exhausted the provisions of the MFA, which had been specifically established as a derogation from the GATT to deal with disruption in textile trade;
- Article XIX action is usually limited to one specific product; the Canadian global quota applied to the whole range of clothing products;
- in resorting to Article XIX, Canada had found it necessary to abrogate a number of bilateral arrangements which had been negotiated under the MFA; and
- in by-passing the *cordon sanitaire* provided by the MFA for safeguard action in the textiles area, Canada had placed great strain on the more general safeguard provisions of the GATT at a time when the whole

GATT system was under delicate negotiation in the Tokyo Round of multilateral trade negotiations.

In addition to these criticisms, Article XIX provides that contracting parties affected by a safeguard action may seek compensation or take retaliatory action. The United States exercised this right and, during the course of a series of consultations, Canada agreed to compensate the United States through a number of tariff concessions.

While the direct and immediate consequences of the decision to resort to Article XIX global action were all manageable, their cumulative effect proved damaging to Canada's trading interests. As one of the leading proponents and beneficiaries of the rule of law in international trade, Canada lost some credibility, and confidence in Canadian negotiators was eroded. The fact that Canada had abrogated two agreements adversely affected bilateral negotiations, particularly with Asian textile-exporting countries, where Canadian negotiators ran into resistance in reaching relatively straightforward understandings. Having decided to act outside the discipline of the MFA, Canada had virtually no influence in shaping the 1976–77 renewal of the MFA. The European Community and the United States froze Canadian negotiators out of the discussions. It took four years of careful effort to return a measure of normality to Canadian participation in international textile discussions. Dissatisfaction with Canadian textile import policy also spilled over into discussions in 1977 involving footwear, where a measure of understanding from the EC could have averted the subsequent global quota on footwear.

In its May 1977 final report, the TCB recommended either the continuation of the global Article XIX measure or the negotiation of comprehensive bilateral restraint arrangements with the 21 supplying countries considered to be the sources of the injurious imports. The TCB's commitment to the narrow sectoral interests of the industry was already beginning to worry independent commentators.

After reviewing various options, and taking into account the difficulties that the global quota had given rise to (including problems of import administration), the government decided to revert to a bilateral approach and negotiate bilateral restraint arrangements under the renewed MFA. The first series of negotiations ended in failure, in part because of bitterness engendered by the global quota and in part because of unrealistic expectations as to what could be negotiated bilaterally. During 1978, however, the government relaxed its earlier expectations, and Canadian officials gradually concluded three-year bilateral export restraint arrangements with Taiwan, Hong Kong, the Republic of Korea, the People's Republic of China,[53] the Philippines, Poland and Romania. These arrangements covered some 80 percent of clothing imports from all sources, as well as a range of sensitive textile items. They came into effect on January 1, 1979, allowing the Article XIX global quota to

terminate on December 31, 1978. In addition, the government instituted a global import monitoring scheme which would provide an early warning of imports from unrestrained sources threatening to disrupt the Canadian market.

In 1979, the government found it necessary to negotiate further restraint arrangements with smaller suppliers. Arrangements were concluded with Macao, Thailand, Sri Lanka, Pakistan, Singapore, Bulgaria, Hungary, Czechoslovakia, India and Malaysia. As a result, virtually all imports of clothing and a significant volume of textiles from low-cost sources entered Canada under quota.

Review, Renewal and Retreat

By the late 1970s, therefore, Canadian textile import policy had shifted significantly away from the principles enunciated in 1970. Adjustment had come to play a minimal role in government policy. The general financial support measures available to the industry (such as the General Adjustment Assistance Program, the Enterprise Development Program, Unemployment Insurance and other labour adjustment programs, including early retirement benefits, the Regional Development Incentives Program, the Adjustment Assistance Benefits Program, and the Program for Export Market Development) were not geared specifically to the special problems of textiles and clothing and were little used by these industries. Import restrictions became the main thrust of the policy but, rather than being temporary, short-term and limited to one or a few products, had since November 29, 1976, affected imports of virtually all textiles and clothing from low-cost sources.

Worldwide technological developments were at the same time accelerating the shift to more capital-intensive production, especially for the primary textile sector, requiring major investment if the industry was to keep up with EC, Japanese and U.S. competitors. Canadian companies, however, would not benefit from the economies of scale available to these competitors. The Canadian market was too small and access to the larger markets too restricted to make longer production runs generally feasible. Clothing production, likely to remain labour-intensive, would continue to be under severe pressure from low-cost producers. It was probable, therefore, that both sectors of the industry would continue to be subject to external factors which would exacerbate their competitive positions. Their long-term viability, except for selected products, was questionable.

There were no indications, however, that the United States and the EC would dismantle their high levels of protection, suggesting that any relaxation by Canada would immediately attract a flood of imports. As the recession of the early 1980s took hold and dampened demand, low-

cost producers continued to increase their production capacity in the vain hope that a market could be found for their products.

Against this background, the Textile and Clothing Board in 1979–80 conducted a thorough review of the textile and clothing industries. Its purpose was to report to the government on the state of the industry and to determine whether the special measures of protection in effect since 1976 should be maintained, modified or removed when they expired December 31, 1981.

In its report of June 30, 1980, the Board concluded that the textile industry in Canada was comparable to any other in the industrialized world and that clothing production in Canada ranked highly in comparison with quality garments from other developed countries. The two industries were by and large technically competent and were planning adequately to meet international competition from industrialized countries. In the Board's view, both sectors would continue to improve their productivity, given assurance of a stable market; this stability or certainty could best be achieved by continuing to restrain imports of clothing from low-cost and state-trading sources, in addition to the tariff protection provided on imports from all sources. It concluded that, in the absence of special measures of protection after December 31, 1981, imports from low-cost and state-trading sources would increase in a rapid and disorderly fashion, causing damage to Canadian production and employment which would be difficult to repair. It recommended extensive protection at 1979–80 import levels for a period of nine years, thereby allowing the industry a long period of stability within which to adjust.

In making these recommendations, the Board argued that the necessary degree of certainty in the Canadian market could best be achieved through the imposition of a quota administered and controlled in Canada against imports from all low-cost and state-trading sources on the basis of specific levels for individual garment categories. However, in recognition of Canada's international obligations, the Board recommended a modified bilateral approach, i.e., the use of restraint arrangements negotiated bilaterally under the terms of the MFA but with country-specific limits from low-cost suppliers on five sensitive items and an aggregate limit on all other textile and clothing products based on 1979–80 import patterns. Second-best, bilaterally negotiated restraints would, in the Board's view, be sufficient to create an environment more conducive to the investment necessary for the further development of a competitive textile and clothing industry in Canada.

The main thrust of the Board's recommendations — the need to create a climate of confidence designed to promote investment — was not dissimilar to a major element of the 1970 Textile Policy. However, the 1970 Policy encompassed the use of limited and selective special mea-

sures of protection and adjustment assistance to achieve a movement toward more viable lines of production in Canada, thus minimizing the need for border actions in the longer run. Since 1976, however, as import pressures had increased, the Board had recommended the use of much broader measures of import protection than originally envisaged in the Policy. By the time of its 1980 report, the Board proposed that, to achieve the necessary climate, federal adjustment assistance programs would need to be retained but the level of import protection would need to be both extensive and continuous over a nine-year period and more restrictive than the levels in place. Thus the Board in its own reviews illustrated the dilemma of a protectionist import policy seeking to induce adjustment. More and more protection is needed because the *need* for adjustment seems to outpace *actual* adjustment.

The TCB report was well received by the textile and clothing industry, but widely criticized by all other sectors of opinion as protectionist and inimical to the interests of Canadian consumers, exporters, importers and Canada's trading partners.

From the outset, it was apparent that the TCB report required major internal analysis to provide the basis for a Cabinet decision. Two efforts were mounted simultaneously. The Low-cost Import Committee concerned itself with the recommendations regarding import measures, and an adjustment working group reviewed possible new adjustment programs, specific to the sector, which could be developed to ensure that future protection would indeed lead to major restructuring and gradually would eliminate the need for special measures of protection. Debate within government raged for ten months. As it proceeded, an impressive lobbying effort was mounted by the industry and rumours of impending announcements added to an atmosphere of crisis and confusion.

The Low-cost Import Committee extensively analyzed the potential impact of the TCB's recommendations, their negotiability, alternative means of achieving the same objective and the impact of less protection. It consulted with the major suppliers of low-cost clothing, the United States and the EC, to gain insight into what was negotiable and what was not. The work of the Committee was complicated by the fact that the MFA was scheduled to expire at the end of 1981, concurrent with the expiry of existing bilateral agreements, and any new agreements would need to be negotiated without knowing whether there would be an MFA and, if there were, the nature of its discipline. It was apparent, however, that the earlier the negotiators received their mandate, the more likely they were to achieve it.

The adjustment group busied itself with an analysis of the long-term prospects of various subsectors of the industry, the effect of further protection on productivity, the availability of scarce funds for adjustment assistance, and the kinds of specific adjustment programs which might work. Extensive discussions were held with Ontario, Quebec and

Manitoba provincial government officials to ensure that provincial and federal programs would be complementary.

By January 1981, both groups had reached a stage where their individual efforts could be combined into a single package for consideration by the Minister of Industry, Trade and Commerce and for detailed interdepartmental discussion among senior officials. A complete package was ready in early February combining border protection and adjustment assistance and a series of options for Cabinet consideration and decision. Long, drawn-out battles were waged involving certain ministers and senior officials, against a background of mounting political pressure from the industry, deteriorating economic conditions, a year dedicated to North-South issues by the Prime Minister, and a shrinking time-frame for negotiations. To compound matters, all sectors of opinion outside government, including consumers and importers, suggested that should the government accept the TCB's recommendation for continued protection, a global quota under Article XIX administered in Canada would be preferable to bilateral agreements under the MFA. Battles royal raged between realists and idealists, protectionists and free-traders, and those espousing good economics versus good politics. The discussions were long, arduous and not enlightening. The paper burden mounted.

By the end of May 1981, Cabinet had considered the issue several times without resolution. Ministers were by now frustrated as they faced a two-inch stack of closely typed analysis and recommendations. The summary assessment note ran on for 43 single-spaced pages. Plans to begin bilateral negotiations had been adjusted three times already. In early June, ministers and senior officials finally developed the outline of a package all could live with. It took several more Cabinet meetings and discussions among senior officials to work out the details. The result was a careful compromise based on long-term protection and a more enriched adjustment package, with small bows to economic and other interests.

The government decision, announced on June 19 at press conferences in Montreal, Ottawa, Toronto and Winnipeg, contained the following two major elements:

- a $250 million, five-year adjustment program to be administered by a new agency, the Canadian Industrial Renewal Board. The CIRB's mandate would be to establish new employment in communities affected by industrial adjustment; to help displaced workers take advantage of new employment opportunities; and to assist the modernization of viable firms in the textile and clothing industries; and
- the negotiation of new five-year bilateral arrangements with low-cost supplying countries within the framework established by the 1979 bilateral agreements.

The announcement came only four days after Prime Minister Trudeau

had made a major address in the House of Commons on North-South relations. Among the themes he stressed was the need for industrialized countries to develop policies that would facilitate the transition from an aid to a trade relationship. Canada and other industrialized countries should not shut the products of the Third World out of their markets but rather let LDCs pay their own way in the world by buying their products. It was a theme he stressed with his summit partners at Montebello several weeks later. His partners were not impressed. They had been briefed on the textile and clothing decision.

The decision testified to the power and influence of the Quebec caucus in Parliament and of federal Quebec cabinet ministers. Ministers did not wish to address the long-term viability of the industry. The decision went as far as possible in the direction of the TCB's recommendations, but with due regard to the realities of negotiation and Canada's international commitments. The contrast between the TCB's recommendations and the final decision is instructive:

- The TCB recommended a minimum of nine years of highly restrictive agreements; the government decided on five years with an opportunity to relax the agreements over time.
- The TCB recommendations bore most heavily on the poorer and smaller exporters; the government decision specifically spelled out the need to improve access for these countries within an overall restrictive framework.
- The TCB recommended little or no adjustment assistance; the government decided on an integrated approach incorporating a rich adjustment assistance program, dedicated to this industry, with border restrictions which could be relaxed over time as adjustment began to take hold.
- The TCB's recommendations were virtually non-negotiable; the government decided it would negotiate mutually acceptable arrangements with low-cost suppliers.
- The TCB's recommendations were inconsistent with Canada's international obligations; the government decision, while taking a broad view of the existing rules, anticipated changes considered negotiable at the multilateral level.
- The government decided it could provide the certainty and predictability sought by the industry and central to the TCB's recommendations, without resorting to the draconian measures recommended by the TCB.

The industry, upon reviewing the decision, was not pleased. In their view, the government had unnecessarily diluted the recommendations of a Board which had conducted an exhaustive enquiry and concluded that the future viability of the industry required strong measures. As usual, it viewed the Board's findings and recommendations as holy writ and the

government's duty limited to implementing the report as quickly as possible. Nevertheless, they were prepared to see the results of negotiation before complaining too vigorously. The adjustment package was given short shrift.

Negotiations on the bilateral agreements had begun a week earlier in Hong Kong. A reluctant Canadian government had agreed that a further delay in starting the negotiations could not be contemplated and the first team of negotiators crossed the Pacific on June 13. The first round with Hong Kong did not augur well. Hong Kong officials, with an eye to impending MFA negotiations and subsequent negotiations with the United States and the EC, were not prepared to set any precedents with Canada. The existing rules would provide the only framework and within these rules, Hong Kong was prepared to be flexible and creative. Canadian officials, however, were not prepared to fail in the first effort, and exhausted every element of possible Hong Kong flexibility and creativity — to little avail. It appeared that at best a one-year bridging arrangement to cover 1982 would be possible. Time for reflection, however, was required.

The first breakthrough came in China. Not being a member of the MFA, China did not share Hong Kong's problems but did appreciate that access to the Canadian market would not grow and that being first to gain a share of a fixed pie could be beneficial. A record of cooperation with Canada would also demonstrate to the EC and the United States that China was not unreasonable. China's appetite, nevertheless, remained keen and the outcome of negotiations was not apparent until 24 hours before the delegation was scheduled to leave. Then, Chinese agreement was complete and, hours before leaving, the delegation initialled a five-year, comprehensive agreement.

The next stop was Korea. Within hours, it was clear that Korea was in no position to respond positively to any Canadian proposal. Three days were spent in exploring the outer limits of each other's flexibility, but to no avail. Korea, like Hong Kong, was not prepared to anticipate a new MFA and create unnecessary difficulties in these negotiations and upcoming negotiations with the EC and the United States. Not even a bridging arrangement appeared feasible.

The Taiwan Textile Federation was next. Because Canada does not recognize Taiwan, the TTF substitutes for the government and meetings are held in some neutral spot — this time Hong Kong. Because Taiwan has no standing in the multilateral trade and payments system, the word "negotiations" does not describe the nature of the discussions. Canadian officials outline what the Canadian authorities are prepared to tolerate in terms of import levels, and the TTF indicates how it could meet those expectations. Canadian officials suggested that tolerance in 1981 would be significantly less than in previous years. TTF officials concluded that without extensive discussions in Taipei they could not

indicate what undertakings they could give. The discussions were extremely difficult, and TTF sought and was given three months to consider an appropriate response.

India was next. It rapidly became apparent that India would not even consider whether it would enter into a five-year arrangement until the MFA negotiations had been concluded. In order to clarify the situation for exporters and importers alike, however, the negotiating teams initialled a one-year extension of the 1980–81 arrangement on the understanding that this temporary arrangement could be superseded by a long-term arrangement when and if such an arrangement could be constructed once a new MFA had been agreed to.

At the end of July 1981, the negotiating team arrived in Geneva to participate in another meeting of the GATT textiles committee. On the margin of that meeting, negotiations continued with Hong Kong and a one-year interim arrangement was concluded to provide coverage for 1982. This arrangement included a provision for a system of export authorization. Such a system, without specifying quotas for any one year, introduced a moving average for some categories reflecting actual shipments which, if they threatened to increase above previous shipments, could be quickly limited. This device, pioneered in the 1978–82 Hong Kong–U.S. agreement, allowed for a more flexible import system and avoided placing quotas on items clearly not disrupting the Canadian market. It would also eliminate the artificial problem of "overhang" whereby, it has been argued, unused quota could, if used in subsequent years, create such a surge in imports as to be disruptive while staying within previously agreed quota limits.

The first round of negotiations had succeeded beyond expectations: one five-year agreement, two interim agreements, and a measure of understanding from three of the four suppliers not covered by a long-term agreement. It had been possible to refine technical aspects of the negotiations and clear the way for discussions with other suppliers after the August break. Unlike a similar situation in 1977, when there had been no understanding at all, there appeared to be no need to seek a change in the negotiators' mandate.

One worrisome factor, however, had crept in. Industry advisors accompanying the delegation had begun to send messages home suggesting that the negotiators were exceeding their mandate: their interpretation of the government's decision differed from that of the officials, and their interpretation was much coloured by the TCB recommendations. While a familiar story, it suggested that problems could arise in the future.

It is not necessary to rehearse in detail the rest of the bilateral negotiations. The first set was the most difficult. Next came smaller suppliers who were entitled to more generous treatment. Most agreed readily to new, five-year agreements. As knowledge of these smaller

agreements became available to the larger suppliers, fear of gaining access to a shrinking share of the pie helped bring them around. Korea had second thoughts and initialled an agreement in late September, stipulating only that the details not be revealed until after the conclusion of the MFA negotiations. The Taiwan Textile Federation followed in October.

By the time the MFA negotiations began in earnest in late November 1981, Canada had concluded five-year arrangements with China, Korea, Taiwan, Malaysia, Thailand, the Philippines, Macao, Poland, Bulgaria and Romania and one-year arrangements with Hong Kong, India, Hungary and Singapore. From a negotiating point of view, it was an impressive achievement for a six-month period. It covered some 98 percent of imports to be permitted in 1982 from low-cost sources at a level equivalent to access permitted in 1979–80 but covering a broader range of garments. The arrangements negotiated had been simplified and standardized, allowing for clearer import monitoring, some flexibility for exporters, and growth for the next five years at approximately 3.5 percent, slightly higher than anticipated market growth. The negotiators had tightened restrictions for the four major suppliers (Hong Kong, Korea, Taiwan and China) and East European suppliers; and redistributed the permitted imports among the smaller, developing countries, which gave them greater access than they had previously enjoyed. In approaching this task, the negotiators had sought to avoid precise targets for each category supplied by individual exporters, but rather to achieve an aggregate package consistent with the aggregate access available to low-cost exporters for the Canadian market in 1979–80. This objective was achieved. It was an approach, however, to which the industry objected.

The unexpected success of the bilateral negotiations immensely simplified the task facing Canadian negotiators participating in discussions on the renewal of the MFA. The task now was to ensure that the MFA was renewed and sufficient flexibility built into its existing provisions to provide multilateral coverage for the new arrangements and thus provide for their effective management for the next five years. At the same time, it would be necessary to ensure that a renewed MFA would not allow the United States or the European Community to negotiate bilateral agreements significantly more restrictive than the new Canadian arrangements. Should such a situation develop, the Canadian government would be under renewed pressure to bring Canada's agreements into line with what could be achieved by the EC and the United States.

The MFA negotiations proved extremely difficult. Canada found its position to be midway between that of the United States and that of the EC, but Canadian negotiators enjoyed the advantage of having gained insight into exporter needs and demands during the previous six months. The EC and the United States, eager to achieve a similar record of

success in their upcoming bilateral negotiations, but with different objectives, were open to suggestions. Unlike the experience during the negotiations in 1976–77, Canada found itself an influential and active participant. By the night of December 17 when the final package was hammered out, Canada was one of only six delegations at the table. The agreement reached that night held, despite intense pressure on the EC to step away from it, and the MFA was renewed for a further four years and seven months.[54]

The renewed MFA met all of Canada's objectives, i.e., it made it easier to restrict low-cost imports from selected sources. It proved possible to find a formula which attracted the support of both exporting and importing members, despite their very different objectives. Exporters sought the gradual liberalization of the existing regime, looking to the eventual elimination of the MFA. Importers sought a more restrictive instrument capable of exerting greater pressure on exporters to accept the kinds of agreements the governments of industrialized countries thought politically necessary to appease their domestic industries. In the end, the renewed agreement provided for continued multilateral surveillance, greater commitment to adjustment, better treatment for small exporters, and a basis for reaching mutually satisfactory but more restrictive agreements with larger exporters already enjoying the lion's share of the low-cost exporters' penetration of industrialized markets. The best had been made of a bad situation.

With renewal of the MFA, it now proved possible for Canada to conclude five-year agreements with Hong Kong and India. While these negotiations were difficult and required a high degree of creativity and compromise on both sides, a level of mutual trust and understanding had been achieved during the previous 18 months of frequent contact in bilateral negotiations and in Geneva, allowing the negotiations to succeed. Both India and Hong Kong had played active and constructive roles in Geneva, a result in part of the expertise of their negotiators and the position of principle both adopted.

By the end of March 1982, only some ten months after negotiations had started, Canada had negotiated a regime capable of providing a five-year period of stability and predictability in imports. This would allow the CIRB to work in a relatively stable atmosphere, and would facilitate gradual adjustment to a more competitive industry that should require less long-term protection by the end of the decade. Only Pakistan, Sri Lanka, Singapore and Hungary, all relatively minor suppliers, had not settled for five-year agreements. For all four, however, interim arrangements had been reached, committing both sides to negotiating satisfactory arrangements and in the interim to controlling imports and exports at acceptable levels until an arrangement could be concluded.

It could have been expected that, having reached this stage, ministers could relax and turn to other issues. Not so. Canada found itself in the

midst of a recession. The footwear industry, taking a page out of the textile and clothing industry's book, sought and received continuation of its global quota, first limited to non-leather footwear and then extended again to leather footwear. Now it was the turn of the textile and clothing lobby to take up the cry again. Their analysis of the new agreements suggested that the negotiators had exceeded their instructions and negotiated agreements which were not in the interest of the industry. By combining previous quotas and providing new categories, as well as by redistributing quotas among suppliers, disruption was, in their view, again occurring. Imports, in their view, were increasing while demand was falling. Worst of all in their view, the EC and the United States were achieving more satisfactory agreements that were more in line with the needs of the European Community and U.S. industries. The Canadian agreements needed to be renegotiated.

This oft-told tale drew support from the Quebec caucus, ministers and senior officials. The complete bankruptcy of 25 years of protectionism was laid bare. The debate again raged furiously behind closed doors all over Ottawa. The CIRB did not escape. It too was a "failure." In its first year of operation, it had taken its mandate seriously and had excluded from assistance firms whose future viability or restructuring plans did not look promising. Facts as to actual import performance, the fall in demand, the state of the economy, and the emerging U.S. and EC agreements paled in significance compared to the increasing pressure from a powerful lobby. No one seemed to realize that, after 20 years of complaining about government inaction and despite a record of government assistance unequalled for any other sector, industry spokesmen had become incapable of any other response. The continuing decline in its competitiveness could not be the result of anything but "unfair" imports and insufficient government effort to control this competition.

As a matter of fact, the bilateral arrangements negotiated in 1981–82 were remarkably similar in effect to those negotiated in 1982–83 by the United States and the EC, although any detailed comparison inevitably becomes one of comparing apples and oranges. They are different agreements negotiated by different entities to meet particular objectives. Similarities exist only at the most general level. The aggregate effect of quota levels, growth, flexibility and pre-existing import penetration suggests, however, that all three entities now run very similar textile and clothing import regimes. This is a significant change from the situation which existed prior to 1976. At that time, the Canadian government took some pride in running a more liberal regime — and industry spokesmen relished calling officials "boy scouts." While the reality has changed, industry and other critics still get favourable mileage out of perpetuating the boy scout myth.

The European Community, the United States and Canada all negotiated agreements for a five-year period. These agreements were not,

however, meant to provide protection capable of shielding industry from a recession. Indeed, other less-protected sectors of the economy suffered more than did the textile and clothing industry in 1982–83. All three governments, however, faced mounting pressure from their textile and clothing industries. The Canadian government sought but failed to curtail further its imports from the major suppliers. Ongoing debate and negotiation, however, had again interjected uncertainty and instability into the industry, once more impeding the adjustment process.

Costs and Consequences

In 1970, again in 1976, and once again in 1981, the government reviewed the problems of the textile and clothing industry. Each time, the government announced it was extending special measures of protection to limit imports from specific countries whose low-cost exports were causing market disruption; these measures were designed to instil stability in the domestic market and facilitate adjustment by the domestic industry to new competitive circumstances. Adjustment, however, continued to lag behind increasing import competition, and the perceived need for additional measures of protection has increased steadily, with protection in fact becoming more restrictive. The state of the industry has remained precarious and vulnerable to import competition. No more eloquent proof could exist that protectionism does not induce adjustment.

It is difficult to calculate the precise costs and benefits of quota protection, but the direction is reasonably clear. One of the principal effects of quantitative restrictions on imports is the redistribution of income. Quotas result in consumers spending money on clothing that could otherwise be spent on other items, thus preserving jobs in the clothing and clothing-related textile industry that would otherwise be lost. At the same time, however, this transfer of consumer expenditures results in reduced spending on other products and therefore reduced employment in other sectors of the economy. Quotas on low-cost imported clothing reduce the quantity and selection of lower-cost clothing available to consumers, which in turn causes the retail price of clothing to be higher than otherwise. Higher prices allow higher-cost marginal output, thereby allowing less efficient product lines and plants to be kept in operation.

The principal recipients of the costs and benefits of quotas on low-cost clothing imports are obvious from the above. The principal losers are consumers, whereas clothing producers and employees are perceived to be the principal gainers. Quotas, imposed on top of a 25 percent tariff, higher than in the United States or the European Community, ensure that Canadian consumers pay higher costs than their counterparts elsewhere. The burden is higher for low-income consumers because of inelasticities in demand.

The reduction in imports also prevents a loss in corporate and personal taxes contributed from the clothing and textile sectors, but causes a reduction in tax collections in those sectors of the economy that would otherwise have benefited from increased consumer spending. Without quota protection, some employees of the clothing and textile sectors would be collecting unemployment insurance rather than contributing to it. On the cost side, the imposition of quotas leads to a reduction in tariff revenue collections on imported clothing by the government.

Because most of the clothing industry is centred in Quebec, residents of Quebec are assumed to be net beneficiaries of quota protection. Ontario and Manitoba are both significant consumers and producers of clothing while the other provinces, on net, transfer income to Quebec as a result of the quotas on imported clothing.

The pernicious effect of protectionism, however, is more basic. In industrialized countries, the textile and especially the clothing industries are usually found to be concentrated in so-called disadvantaged areas. However, one of the reasons the area is disadvantaged is because the clothing industry is concentrated there. The clothing industry is characterized by low pay, relatively low skill levels, low quality of working life and few prospects for advancement, high vulnerability to international competition, and heavy dependence on government assistance. In Canada, the structural weaknesses of the Quebec economy are largely attributable to the concentration in Quebec of the textile, clothing, footwear, furniture, and shipbuilding industries, all mature or "soft" industries. Any policy which encourages more viable employment opportunities should thus be welcomed. In fact, however, continued protection of these industries and financial assistance to them have maintained a low-wage, dependent status for the regions in which they are concentrated. The burden is increased by the fact that the more prosperous regions of the country, which tend to be more competitive and integrated into international markets, resent having to pay for protection for an industry with few, if any, long-term prospects.

Protection to structurally weak industries, especially by means of negotiated quotas, also has a negative impact on the export interests of the more competitive regions of the country. Limiting the exports of Hong Kong, Korea, Taiwan, and the ASEAN countries denies them the foreign exchange with which to buy coal, lumber, and CANDU reactors and, more recently, Canadian service exports such as engineering and construction.

It is apparent, therefore, that long-term import controls act as a poor instrument for inducing structural adjustment in a mature industry. Rather, they tend to protect and perpetuate an uncompetitive industry, lock workers into low-wage, low-quality jobs, condemn currently disadvantaged areas to long-term uncompetitiveness, misallocate labour and capital resources, reduce the nation's economic development potential,

increase inflation and irritate consumers, worsen interregional tensions, and damage Canada's international credibility. Import controls, however, also raise a set of other problems related directly to the techniques used. Tariff measures, which affect competition through the price mechanism, tend to be relatively neutral and non-discriminatory policy measures. They still allow the most competitive offshore producers to penetrate the market, albeit at a higher price level. Quotas, however, have a much different effect, particularly when they are bilaterally negotiated and export administered.

One of the principal disadvantages of the bilateral approach (i.e., as opposed to a global quota) is the shifting to unrestrained sources, either to avoid established restraints or in response to increasing capacity in new sources coming on stream. For example, during the course of 1979, it proved necessary to increase the number of bilateral agreements from six to fifteen. When shifting occurs, the first difficulty arises in determining the level at which increases in imports become potentially disruptive. To meet this problem, "trigger levels" have been established and incorporated into the monitoring system in order to provide early warning of increases in imports from new suppliers. However, it is difficult to evaluate whether these levels are or will continue to be appropriate, and at what point further steps should be taken. Further, once importers begin to shift to new sources, it is difficult to determine whether the new sources will provide additional imports or will replace old imports. If the former, overall imports may become too large in relation to overall market demand and domestic production, exacerbating a situation determined to be injurious. The MFA requires, however, that new entrants be treated generously. Import levels must, therefore, be set at more than token levels. Since the MFA does not provide for rollbacks of existing levels but rather requires "growth" in restraint levels, there develops an increasing "overhang" of potential imports, access for which is guaranteed by the existing restraint arrangements.

Importers have complained that they are charged a surtax to obtain export quotas from various suppliers, inevitably leading to higher clothing costs. This practice, however, is an accepted part of export restraint arrangements and represents the payment exporters expect for restraining their exports. Their extent and effect are difficult to document. The long-term impact, however, tends to be neutralized by the competition from alternative sources and by domestic market demand. In some cases, quota charges are responsible for the under-utilization of restraint levels in certain countries. They illustrate, however, the gradual development of a subindustry earning a living from quota administration and manipulation. It should be noted that import administration creates a similar if less well advertised subindustry. Because the buying and selling of quotas is illegal in Canada, the subindustry is less open and thus perhaps even less desirable.

Despite the high level of special measures of protection which have been extended to the Canadian textiles and clothing industry, as well as a tariff in the 20 to 25 percent range largely unaffected by various GATT rounds, the domestic industry continues to press for the concurrent application of contingency protection: valuation uplifts, anti-dumping duties, countervailing duties and surcharges. Applying two or more measures to achieve the same result has been called double jeopardy. While in some instances doing so makes good sense, in many situations a valuation uplift or anti-dumping duty does not serve broader policy interests. They increase, for example, the cost to consumers and have exacerbated the problem of supplying the low end of the market. Furthermore, exporting countries react angrily to situations of double jeopardy. Since, under a bilateral regime, the quota levels must be renegotiated periodically, the ability to negotiate a desirable level can be severely prejudiced by a situation of double jeopardy. Indeed, the MFA specifically enjoins participants from resorting to measures of protection additional to those provided for in the Arrangement.

The Canadian textile and clothing industry is a fully integrated industry manufacturing a full range of textile and clothing products. It does not, however, produce this range in sufficient variety to fully satisfy either consumer demand or, at the textile level, the requirements of clothing manufacturers. Further, at the raw material level, Canada does not produce cotton, sufficient wool, or man-made fibres to meet the requirements of spinners, weavers and knitters. There is, therefore, an absolute requirement for imports at all stages of production, whether from industrialized or low-cost sources. The industry, however, is not vertically integrated to any large extent. Further, many elements in the industry are emotionally and philosophically opposed to imports. There is no consensus in the industry on what would constitute a rational import policy. The bonds between the various sectors are tenuous, but all agree on the need for import controls. They do not agree on what should be controlled: spinners want controls on yarns; weavers want controls on fabrics, but not on yarns; clothing manufacturers want controls on clothing, but not on yarns and fabrics. Clothing manufacturers complain bitterly that Canadian weavers will not supply them the range of fabrics they require in order to manufacture an attractive range of products. At the same time, the weavers, through industry-induced government actions, deny clothing manufacturers easy access to cheaper imports (which would make the manufactured products more competitive) through quotas, high tariffs, anti-dumping duties and valuation uplifts.

This rivalry complicates the development of a more widely accepted import policy, and has contributed to the sour relations between importers and the industry and between importers and the government. The industry needs imports and the consumer demands imports, but the

importing community is regarded as the pariah of the industry. Officials, however, must devise policies which are responsive to the legitimate interests of the importing community. Quotas cannot, for example, be imposed arbitrarily when importers have committed funds to an offshore manufacturer.

In devising and administering a responsible import policy, officials must also ensure that the market is supplied adequately with a full range of consumer products covering all price points. This is not easy. In an uncontrolled market, market forces usually ensure this. With global controls, competition among importers decreases, as each is ensured a certain portion of the market. Profits are at a maximum since quota shares are allocated to importers who can set wholesale prices slightly below those of domestic manufacturers but well above landed import prices. Domestic manufacturers have largely abandoned the low end of the market to low-cost imports. However, once controls are in place, importers are reluctant to supply this market because of low profit margins.

With global quotas, supply to the low end of the market is uncertain. Once a comprehensive system based on bilateral export restraints is in place, it becomes precarious. Exporters do not regard restraints as a limit but rather as guaranteed access and they seek to maximize their profits. The import share of the market is supplied by a sellers' market and exporters begin to trade up — moving from the low end of the market to the more profitable middle. Hong Kong, Korea and Taiwan now supply 70 percent of the total Canadian import market for clothing by volume. Whereas in 1970, for example, the value was relatively low (37 percent by value compared to 54 percent by volume), it is now in the middle (some 70 percent by value). The high-fashion, high-risk market, where profits are highest, is even beginning to be supplied by so-called low-cost sources, which is one of the reasons importers have begun to shift sources. As a result, in order to provide a full range of goods at all price points, a high level of imports from some sources is necessary (e.g., China and India). Even these sources, however, are beginning to trade up.

The proliferation of comprehensive quota regimes among all the major importing countries has stimulated imaginative attempts by importers and exporters alike to evade these quotas. For example, Hong Kong manufacturers are alleged to be affixing "Made in Indonesia" labels to some garments and shipping them to Indonesia, whence they enter Canada as goods of Indonesian origin. However, should Canadian officials attempt to negotiate an arrangement with Indonesia, officials there can rightly claim that they have insufficient production capacity to warrant a restraint program and that they will not restrain their few legitimate exports in order to solve what they perceive to be a Hong Kong–Canada problem. Hong Kong can rightly claim that they run a free

economy and cannot restrain exports to Indonesia, with which they do not have a restraint arrangement. Canada Customs do not have the resources to open all shipments and investigate to the extent necessary to reach a conviction. The result is a stalemate, and the increased imports further disrupt the Canadian market and upset the industry.

The Burden of Interdependence

The United States government is a staunch believer in the thesis that restrictions in the textile area ought to be limited to low-cost suppliers and that low-cost is by definition developing or state-trading, i.e., low-cost is based on low labour costs and low labour costs are "unfair." Low-cost imports based on economies of scale, low material costs or high investment in capital are not "low cost" but "competitive." The United States frequently reminds its trading partners that industrialized importers must act collectively and that any attempt to restrict the trade of others would serve no one's interests.[55] This attitude is one of the reasons that the United States aggressively pursued compensation when Canada took Article XIX global action.

The United States' attitude is understandable: the U.S. industry is the most efficient producer of primary textile products and, in many instances, it is the lowest cost producer. Because of cheap fabric input, some U.S. clothing products compete directly with those from Hong Kong and Korea. The United States is by far the largest supplier of the Canadian market. More than 50 percent of Canada's imports of textiles are from the United States on a value basis, as is a significant level of Canadian clothing imports. The European Community, although not as efficient as the United States, for historical reasons remains the world's largest exporter: 1981 exports totalled more than US$15 billion (70 percent textiles, 30 percent clothing). Yet the United States was initially the sponsor of the current international regime, and the European Community of the subsequent tightening of the regime.

The development and administration of a sane and responsible textile import policy thus are severely constrained by the international trade policy framework within which they must be conducted. The fact that the United States has successfully pursued a protectionist trade policy in the textiles and clothing sector for more than 25 years has increased the burden on other importers. The burden on smaller importers was increased in the mid-1970s when the European Community, facing rapidly increasing imports of apparel and no longer wishing to rely on selective restrictions and on an imaginative array of illegal non-tariff restrictions, adopted the comprehensive U.S. approach. The rapid growth of productive capacity for export in developing countries (South Korea increased its capacity tenfold between 1971 and 1979) was aimed at the U.S. and EC markets. When access to these two markets was found

to be largely controlled, the pressure on smaller importers increased proportionately. Any one of the major exporters is now able to supply a preponderant share of the Canadian apparel market. Without controls, therefore, the Canadian market would be engulfed.

The Multi-Fibre Arrangement (MFA) was conceived in 1972–73 as a logical extension of the Long-Term Arrangement Regarding International Trade in Cotton Textiles (LTA). Both the LTA and the MFA set out special rules allowing participants to take discriminatory restraint action in the textile sector, thus ensuring orderly marketing under agreed international joint disciplines. The justification for this derogation of the provisions of the GATT was the rapid and disruptive entry on the international market of low-cost products from suppliers in Asia. A widely held opinion at the time was that the problem of low-cost disruption would require some form of derogation from the MFN rules of the GATT for a while, and that the adjustment by textile producers in industrialized countries to this phenomenon would take a few years. The few years have since stretched to 25. Recently, however, the characteristics of the textile industry have undergone a basic transformation, calling into question the continued relevance and basic assumptions of the MFA as currently conceived.

The international textile market is now dominated by seven major traders: the United States, the European Community, Japan, the Republic of Korea, Hong Kong, China and Taiwan. The first two are net importers but are able, because of characteristics such as economies of scale, to produce a wide range of attractive and internationally competitive products. The long-term threat of disruption in U.S. and EC markets by low-cost suppliers is limited not so much by the current restraint regimes as by the facts of economic life. In the yarn and fibre areas, the United States is now more competitive than a number of so-called low-cost suppliers. In the primary textile sector, the factors in international competition are not "unfair" elements such as labour costs, but rather differences in corporate tax rates and distance from the end market. In the apparel field, the practice of "trading up" by major Asian suppliers has resulted in direct competition between domestic and offshore suppliers on the basis of quality, style, closeness to the market, and access to a distribution system, rather than strictly on the basis of cost. The question, therefore, of whether or not a supplier is low-cost may become less important. Some of the major producers are losing interest in the low end of the market, and now produce a wide range of high-quality, high-fashion and, at the retail level, high-priced end products. The MFA quota system has accelerated this development by guaranteeing major offshore producers a share of the major industrialized markets without specifying what this share should be. The result is the practice of trading

up, by which offshore suppliers switch from low-value to high-value items within the same quantitative restriction.

The concentration of the international textile market has been accelerated by the recent decline in demand. As long as the total international textile market grew rapidly, as it did in the 1950s and 1960s, there was enough demand to satisfy all traders. The period of recession and slow growth since 1973, however, has changed the picture. New entrants and minor participants, especially among LDCs, are finding it increasingly difficult to find a place in the market. The less efficient domestic industries in smaller importing countries are finding it more difficult to compete. The combination of greater fashion consciousness among men and the coming to maturity of the postwar baby boom in the major industrialized markets ensured healthy growth rates during the 15-year period from 1958 to 1973. However, current demand and the inelasticity of the textile market indicate that this phenomenal growth is unlikely to be repeated in the near future. The result will probably be that the predominant share of the international market now held by a few will not change significantly.

Smaller exporting and importing countries find themselves in an unenviable position. The former cannot be considered beneficiaries of the MFA system because the arrangement discriminates in favour of established suppliers against new entrants, although the text suggests otherwise. Practice has demonstrated that the combination of growth rates, established quantitative restrictions, comprehensive agreements, and a declining market make it virtually impossible for new entrants to make substantial inroads into the major markets. The MFA, therefore, does not meet the aspirations of genuine LDCs. It is doubtful whether in the long run the pious promises of the MFA preamble, which have no real support in practice, will continue to meet the exigencies of North-South relations.

Neither can the smaller importing participants be considered beneficiaries of the MFA. The arrangement makes it difficult for the domestic industries in these smaller importing countries to improve their position in the market once import penetration is high, since MFA growth rates and the illegality of rollbacks favour established exporters. Indeed, many smaller importing governments wish they could find a way to phase out the less viable elements of the industry in an orderly fashion. But the existence of protectionist regimes in the United States and the European Community makes it difficult for these governments to face their industries with anything other than their own protectionist regime. The current MFA thus will continue the process of eroding the place of the domestic industries in these smaller importing countries until the point of no return is reached. For some countries, it may already have

arrived. The MFA has locked these countries into a system from which they find it difficult to escape.

Solving the Textile and Clothing Dilemma

The 1970 Textile Policy in Canada sought to provide a sense of direction, a framework and conditions within which the textile and clothing industries could plan, invest and develop viable lines of production on an increasingly competitive basis internationally. The only long-term protection granted the industry would be that afforded by the tariff. Safeguard measures were perceived as providing temporary relief from injurious imports while the domestic industry, using the adjustment programs provided for under the policy, sought to improve its competitive position vis-à-vis these imports. In addition, the Textile Policy declared that special measures of protection (quotas, surtaxes, voluntary export restraints) would not be implemented to encourage the maintenance of lines of production which had no prospect of becoming competitive with imported products. On balance, it appeared to be a responsible, even courageous policy, especially compared to practice in the United States.

The imposition of a global quota in 1976 on all imports of clothing under Article XIX and the subsequent negotiation of bilateral restraint arrangements with all of the major suppliers of clothing to the Canadian market represented a significant departure from the philosophy embodied in the 1970 Textile Policy. These controls extended protection to a wide range of clothing and textile products which have gradually taken on a permanent character. In addition, the clothing products covered by these arrangements are no longer strictly low-cost products, but include those which fit into the medium-price range and compete directly with Canadian production. The extension of this policy to 1986 underlined its permanence.

This dramatic change in the application of the policy in response to fundamental changes in the quantity and types of imports being supplied to the Canadian market initially gave rise to a degree of uncertainty both domestically and internationally about the future conduct of the Textile Policy. The permanent character of protection gradually has removed this uncertainty. Nevertheless, it would appear profitable to conduct a thorough, public and independent review of the objectives and assumptions underlying the 1970 Textile Policy, as amended in 1976 and again in 1981, to determine whether they remain valid. Such a review could not be conducted by the Textile and Clothing Board since it is perceived to be part of the problem.

One of the reasons the textile and clothing policy has failed to deal adequately with the adjustment problem is that decisions concerning how to implement the 1970 Textile Policy were made within the narrow

framework of the sector. Policy positions on adjustment were developed by officials responsible for servicing the industry as a client, and they thus had a vested interest in its continued existence. Positions on trade policy were developed by officials responsible for negotiating and administering the quotas, and thus again they had a vested interest in the continuation of the policies. Policy development over the years has been largely isolated from such broader concerns as managing the economy, adjustment in all sectors, inflation and foreign policy. When coupled with the political pressure generated by the industry, the development of a more forward-looking policy appears difficult and could only be accomplished by a blue-ribbon panel, separate from the normal policy process.

In essence, such a review would seek to develop an assessment of the costs and benefits accruing to the Canadian economy from various policy alternatives such as a continuation or an increase in the present levels of protection, or alternatively a reduction in the levels of protection with a greater emphasis on industrial adjustment. With respect to costs, the review should examine the impact of the various policy options on consumer prices, on the misallocation of productive resources, on commercial and economic relations with supplier sources, and on federal-provincial relations arising from an uneven distribution of the costs and benefits of protection. The analysis should also include an examination of the role of the distributive trades in price formation, given their increasing involvement in importing and their high degree of concentration. On the benefits side, the review would seek to quantify the impact of these policy options on the levels of employment in production and support industries, on investment and on the use of existing capital. The review should also examine the social costs and benefits of adjusting away from this industry the economies of small towns and villages which depend in large part on the clothing and textile industry for their livelihood. Throughout this review, care would need to be taken to differentiate the short-term dislocations from the longer term implications.

While an independent, thorough review would generate the kind of information needed to develop a better policy for the late 1980s, a better domestic policy will not be persuasive to the various special interests involved as long as there is an MFA and as long as the United States and the European Community continue to practise their highly protectionist regimes. In this sense, Canada has been more victim than villain. The U.S. Administration would like to find a way out of the nightmare of protectionism for this sector. Any tendencies in this direction should be encouraged, for ultimately only the United States can ensure the demise of the MFA.

The eventual demise of the MFA would be helped if Hong Kong and Korea would be prepared to say no to further requests for export

restraints. They could insist, on the expiry of the current MFA, that their trade relations with the major importers should in future be conducted within the GATT. Such a development might be assisted if there were a more broadly based GATT negotiation in the future that involved developing country trade interests.

A new safeguards agreement would help to make the transition away from the MFA easier. However, prospects for an early safeguards agreement are not good. Yet perpetuation of the MFA regime is likely to continue to be a drag on the safeguards discussions. Re-imposing the burden of textiles on the normal GATT system could in itself be a catalyst to achieving a new safeguards agreement.

Chapter 7

Prospects for Canadian Industry in an Interdependent World

. . . for whatsoever a country soweth,
that shall it also reap.
— With apologies to St. Paul

Canada faces formidable challenges for the rest of the decade, challenges which must be met if Canadians are to maintain and improve their standard of living and quality of life. The Canadian economy has not adjusted sufficiently to the competitive challenges an open economy faces. The fact that this challenge also exists for many of our trading partners provides hope and underlines the urgency of addressing the issues at hand from the right perspective. While economic growth through trade is not a zero-sum game, changed circumstances strongly suggest that not all nations will benefit equally or nearly so from trade-induced growth in the future. The ability to take advantage of employment-stimulating trading opportunities will thus to a large extent depend on the economic climate fostered by government policies and on the willingness of the private sector aggressively to pursue opportunities and overcome obstacles.

Decisions by the private sector give real effect to the broad objectives and priorities for Canada's further economic development. Governments, however, foster the trade and economic environment which strongly influence the activities and decisions of the private sector. Businessmen will not be prepared to make the necessary changes and invest funds to promote adjustment and industrial renewal and to capitalize on Canada's potential strength in foreign markets unless they have a reasonable degree of confidence about the nature of the domestic and international trade and economic environment within which they must operate.

Adjustment and Protectionism

Sound macroeconomic management of the economy is basic to Canada's future economic well-being, as is the need for a positive attitude toward adjustment by both government and the private sector. Those adversely affected by changes in the international economy must adapt to the changes. In an interdependent world, the option of resisting or impeding change does not exist. This is a hard fact which governments in the 1970s and early 1980s tended to ignore. The multilateral system helps governments to meet this reality. Governments must have political support for their actions to survive. External obligations facilitate the process of not bowing to political pressure from adversely affected groups. While acquiescence often appears to translate into immediate political support, it is a transient support which tends to require constant reinforcement.

Throughout the 1970s governments increasingly intervened in the economy, positively to encourage growth by removing obstacles to the efficient operation of the market or to alleviate suffering, and negatively to accommodate complaint by creating obstacles to the operation of the market. It is difficult to criticize government policies aimed at reducing socio-economic hardship arising from adjustment or smoothing the process of adjustment. But governments tended to intervene too widely and too often for political ends with questionable economic results. When governments intervene to allocate resources more efficiently or to provide a more socially acceptable distribution of costs and benefits, political judgments are exercised. Political judgments are more readily influenced by specific and narrow sectoral or producer interests than by broadly based national, regional, fiscal or consumer interests. Narrow interests are usually on the side of protectionism and favour delaying or avoiding adjustment. In addition, ministers and public officials tend to have a pessimistic view of domestic industry, induced by their frequent contact with the less successful elements. Successful entrepreneurs eschew contact with government; rather, in their view, government exists to deal with problems. The interventionist habit is thus nurtured by the expectations of those elements of the private sector with which government is most frequently in contact. An unfortunate by-product of this phenomenon is skepticism about new horizons, about ventures which can succeed without government intervention. Such ventures would benefit, however, from positive adjustment and framework policies.

It may be tempting to delay adjustment, and indeed, such measures as quotas or subsidies bring immediate relief and political benefits — but they entrench the problem. A non-competitive activity in an open economy needs an ever-increasing battery of aid, as has been amply demonstrated in the case of textiles and clothing. Labour, management,

machinery and materials all become locked into a marginal activity, perversely drawing resources from more efficient activities to pay for maintaining a non-competitive sector. Short-term help to ease adjustment may be readily defensible, but too often it rapidly evolves into long-term help to avoid adjustment. Policies must thus be carefully designed and implemented to avoid crossing the line from one to the other.

Distortions created in one sector will often, through the market mechanism, affect other sectors negatively. Appeals for protection from one sector can set off a chain reaction requiring offsetting measures, amplifying resource misallocation and lowering economic performance. Some of the rules entered into by governments collectively help individual governments with the constant political pressure on them to cross the line. A large part of the purpose of the various multilateral instruments, but particularly the GATT and the IMF, is to facilitate the task of adjustment, i.e., to spread the burden of adjustment among the many rather than the few. While the system helps, it is not a panacea. The conflict between politics and economics remains. This thought was well expressed by a U.S. deputy secretary of the treasury, who was reflecting such doubts and frustration in the United States:

> . . . politicians always look at a shorter time horizon than economists. There's little political future in good economic policies. Indeed, in a free society, too often good economic policies and good politics are antithetical.[56]

The MFA bears eloquent testimony to this truism and to the failure of the international system to develop an adequate framework to encourage adjustment.

Because of the political difficulties in following an appropriate course in fiscal policy, it is often left to central bankers and monetary policy to fight inflation. Similarly, because of the political difficulties in following an appropriate course in adjustment policies, it is left to trade officials and trade policy to fight protectionism. Both approaches are second best but pragmatic. In both instances, decisions taken collectively in international forums help central bankers and trade officials to provide good advice and help politicians to resist pressures from narrow interests. The challenge is for trade and monetary officials to devise policies that will lead to worldwide economic growth of benefit to individual countries.

Trade Policy and the Multilateral System of Rules

Trade policy is one of the instruments at the federal government's disposal to stimulate adjustment toward a more competitive and productive economy. The existence of a tariff, the denial of quantitative restrictions, the vigorous pursuit of multilateral rights, the speedy implementation of anti-dumping duties, the availability of government-guaranteed

export credits, all can positively influence investment decisions. Over the years, the deployment of these and other trade policy instruments has done much to influence the characteristics of the Canadian economy. To a large extent, Canadian trade policy has been, and will continue to be, developed as a trade-off between the business objective of improved access to foreign markets, the economic need to promote efficiency and competitiveness, and the political need to provide protection for those Canadian industries considered important in terms of national or regional interests. Decisions on the design and use of particular policy instruments are much conditioned by factors external to Canada, particularly those flowing from the international trade and payments system.

The multilateral dimension of the system is experiencing severe strains from protectionist pressures. The system is still fundamentally healthy, but protectionist pressures challenge governments to manage the system positively and constructively. Protectionism is infectious and can contribute to an overall unhealthy atmosphere which can have a deep psychological effect on investment, for example. Recent protectionism is symptomatic of deeper economic problems, common to all the industrialized countries. Sound economic policies which provide for economic growth and which encourage adequate investment will in turn mitigate demands for protectionist measures.

Significant protectionist measures have been adopted in recent years despite the political commitment by government leaders to resist this trend. Measures by most OECD countries in a variety of sectors such as textiles, clothing, footwear, steel, automobiles, agriculture and export credits are clearly protectionist and have brought into question the effectiveness of the multilateral trading order in containing protectionism. Nevertheless, multilateral instruments will hold as long as governments agree systematically to tackle the issues to ensure that the system adapts to today's circumstances. Consultations among government leaders at Economic Summits and among trade officials at Quadrilaterals can be instrumental in this regard. Success in this effort will require forward-looking policies and a willingness to accept some sacrifices. The continued implementation of the results of the Tokyo Round and the recent progress in bringing the export credits race under control are positive signs of continued commitment to an open multilateral trading order. The continued existence of the Multi-Fibre Arrangement and concomitant bilateral agreements, as well as the continued inability to negotiate a satisfactory safeguards agreement, indicate nevertheless that there remain fundamental challenges.

One of the difficulties in containing protectionism in a period of slow growth is that all countries perceive themselves as more open, i.e., less protected, than their trading partners. They translate this perception into a justification for their own protectionist measures as well as a basis

for attacking the measures taken by others. This attitude was fundamental to the growth in beggar-thy-neighbour policies in the 1930s and threatens to emerge again today. All countries now have at their disposal a wide variety of techniques to regulate their trade either directly or indirectly. None is without sin in using such measures in excess. The effort of the past 35 to 40 years has been to bring such national practices under international discipline and promote the rule of law.

Canadian Experience and Areas for Future Attention

Canada has an effective regime largely capable of protecting Canadian producers when and if necessary. The danger is that the system can be and has been abused and that its full and frequent use is not necessarily in the long-term Canadian interest. It is not in the Canadian economic interest if it protects uncompetitive producers, especially if their capital and labour can be used more productively elsewhere. It is not in the Canadian interest to extend protection where such measures will inevitably lead to retaliatory action by our trading partners and close markets for competitive Canadian producers. There is thus a fine line between legitimate protection and protectionism — and that fine line is easily crossed during a period of economic stress. Canadian actions in the automobile and footwear sectors are cases in point.

Much is made in Canada of the fact that we remain a resource-based economy, as if this were a condition to be ashamed of. It would be strange if Canada were anything but a resource-based economy, denying itself the advantages of one of the greatest storehouses of natural resources in the world. A more important consideration is what Canada has done with these resources. While not such as to provide room for complacency, the Canadian economy has become diversified and the level of processing of indigenous resources has steadily increased, particularly in the past three decades. At the same time, the number of people employed in farming, mining, lumbering, fishing and even basic manufacturing has steadily decreased — denoting improved productivity — while employment in the service sector, secondary manufacturing and high-technology sectors has steadily increased. The beginning of a trend toward what have been called knowledge-intensive activities is perceptible. A survey of the various sectors of the economy contained in *A Review of Canadian Trade Policy*[57] demonstrated that the strong sectors are those which are resource-based or technologically sophisticated and integrated into international markets. The weak sectors are those relying on imported or widely available resources and technology and not well integrated into world markets. The biggest constraint on Canadian economic growth continues to be the fact that we do not have unimpeded access to a domestic market of at least 100 million people. This is especially true in an era of specialization. But this constraint has

decreased somewhat as a result of participation in the multilateral system through which tariffs came to be decreased within a system of firm rules. Future negotiations, either multilateral or bilateral, should further reduce this constraint.

Much also continues to be made in Canada of regional diversity, again as if being different were a liability. Both resource extraction and exploitation, and manufacturing, can be found in all ten provinces — but manufacturing continues to be concentrated in Ontario and Quebec, as is Canada's population, for reasons of history, proximity to the major U.S. market and availability of infrastructure. This pattern is unlikely to change significantly in the future. The strength of the country lies in its regional diversity.

While Canada remains a resource-based and regionally diverse economy, it is not a resource-dependent economy. The distinction is real and important. Resource-dependent economies typically experience the boom-bust syndrome of a country dependent on the fortunes of one or a few commodities. Canada last suffered this kind of depression in the 1930s with the collapse of the Saskatchewan wheat economy. The regions of the country are now less dependent on the fortunes of one or two basic commodities. Every region of Canada provides a reasonably diversified economy with patterns of interprovincial trade now such as to strengthen interprovincial interdependence.

We live today in an age of specialization and interdependence. Both factors have contributed significantly to economic integration and growth. Current and future economic development policies need to take account of these factors. International rules provide a framework to facilitate decisions sensitive to this dimension of current Canadian reality. There is thus no need for a fundamental shift in Canada's trade and economic policy. There *is* need for constancy and adherence to the rules.

The test of the international system for Canadian producers lies in whether the government can improve market access for those sectors where Canadian production is or can be competitive on world markets and whether it will protect current access available to Canadian producers. Canadian producers need to be confident that their access is secure and that foreign governments will not move to frustrate the efforts of Canadians to market their goods abroad. The government must thus demonstrate the political will to meet these objectives and to manage Canada's foreign relations carefully.

In order to encourage our partners to negotiate with us, the government must be prepared to deploy its bargaining power. Canada's bargaining power is found in three main areas. First, improved access to the Canadian market could be negotiated in exchange for foreign concessions. Our market is of significant interest to our trading partners and is still protected by a tariff which is relatively higher in a number of

product sectors than that of other industrialized countries. Our natural resources also confer a certain leverage in negotiations. Canada, with its market economy and stable political environment, is regarded by the major industrialized countries as a secure source for a range of raw materials.

Second, Canada should be prepared to negotiate strengthened GATT provisions, including such sensitive issues as export restrictions and export taxes, which would have the effect of further enhancing Canada's reputation as a reliable supplier of resource-based products. Efforts to strengthen the international trade rules should also include the area of emergency action against imports where international efforts to negotiate a safeguards agreement have so far been unsuccessful. Among things that could be done are: bilateral and plurilateral negotiations as stepping stones to a broader consensus of what is negotiable; calling Japan to account for its policy of bilateral accommodation; and dismantling recent protectionist measures inconsistent with the rules, such as the quota on footwear and the arrangement with Japan on automobiles. Furthermore, Canada should pursue a vigorous dialogue with other countries to determine which other nations are prepared to cooperate with us in the pursuit of our objectives. Our goals will be realized more easily if others are prepared to deploy their bargaining leverage in support of common objectives.

Third, defence of Canada's international trade rights should be an important aspect of Canadian foreign policy. The government must be prepared to exercise the necessary will to try to make the GATT system work effectively and to ensure that our trading partners do not impair the value of concessions negotiated for Canadian exporters. Efforts to strengthen the dispute settlement system should be supported. As a corollary of this, the Canadian government should be prepared to live by the international rules.

The government should discuss with the provinces and the private sector the formulation of trade policy to ensure that the best possible national consensus can be developed. With the provinces, consideration should be given as to whether the current methods of consultation are sufficient or whether new mechanisms should be envisaged. With the private sector, the government should consider whether some form of strengthened consultation would be appropriate, perhaps along the lines of the American industry sector advisory committees. Both kinds of consultations should aim at instilling confidence in the federal government's commitment to an open multilateral trading system.

There is no substitute for competitiveness nor for an aggressive private sector vigorously pursuing markets for its products. Nevertheless, an active and well developed export development program, especially one geared to assist medium and small companies, should continue to be

an important element in the government's trade strategy for the 1980s. Basic to this dimension is an active defence of Canada's access to world markets through invocation of Canada's trade agreement rights.

An important area of choice open to the government will be the extent to which it seeks to achieve its objectives through the multilateral framework or through bilateral agreements. In the current multilateral order, it would seem to make sense for Canada to pursue those objectives which can be realized multilaterally in that context. However, there may be certain other objectives which do not readily lend themselves to multilateral solutions and which the government may decide to pursue on the basis of bilateral negotiations. The government will thus need to decide the relative weight to be given to the use of bilateral channels in seeking its objectives. This is particularly true for our objectives in our relations with the United States.

Progress in the GATT should not make us complacent about the need to continue to explore all ways and means to gain better and more secure access to foreign markets, especially the United States market. A constant bias towards liberalization is important not only for our export industries, but also to maintain competitive pressures on the domestic economy. The clear lesson of past experience suggests that failure to pursue trade liberalization vigorously leads inevitably not to maintenance of the status quo but to new restrictions. The forces of protectionism can always be counted on to devise new barriers or to make imaginative use of old barriers to frustrate trade. Containing these forces requires ongoing trade liberalization initiatives. While the GATT will remain the major forum for trade liberalization, it should not be looked on as the only forum. Opportunities should be seized wherever they are found.

Canadian well-being is substantially dependent on relations with the United States. While the basic Canada–United States relationship is not likely to change in the near future, there is significant scope for the reduction or removal of barriers to cross-border trade and for improving the management of bilateral issues in a variety of areas. Discord in Canada–U.S. relations can act as a significant constraint on Canadian policy making; mutual commitment to common goals can open substantial opportunities. New efforts to liberalize bilateral trade and to improve the management of bilateral trade and economic relations should thus figure prominently in Canada's agenda for the future.

Should the international situation evolve in an unforeseen manner so that the multilateral system were no longer seen to be the most viable vehicle for dealing with Canadian trade interests, it would be necessary to rethink Canada's place in the world. Were such a situation to develop, Canada would no doubt fall back on bilateral relationships with its major partners with a view to salvaging the negotiated benefits which Canadians enjoy in those markets. Pursuing such a doomsday scenario in the

context of this paper, however, would seem to be of limited utility. It would also lend credibility to otherwise unacceptably protectionist arguments. Canada is part of the multilateral system and little purpose would be served by thinking of alternative strategies. Canadian trade policy in the 1980s should thus continue on the foundations which have been built over the past several decades with careful regard for the facts of life. The need to cope with the tough international environment of the 1980s and the need to facilitate adjustment and the revitalization of the Canadian economy will require a clearly stated and careful approach based on a strong national consensus. It is of vital economic importance for Canada that a rule-oriented system be preserved and enhanced.

Notes

This paper was in large measure completed in February, 1985.

1. William Mulholland before a panel of international journalists during the 1982 Annual Meeting of the IMF in Toronto, September 8, 1982.
2. Canadian fascination with coordination and central agencies is well captured by Campbell (1983).
3. Canada, Department of External Affairs (1983b), p. 1.
4. See, for example, Stone (1984), which contains extensive bibliographic notes; Plumptre (1977); and Canada, Department of External Affairs (1977).
5. Eloquent testimony to the large and constructive role played by Canada and Canadians in designing and implementing the postwar trade and payments system is provided by Plumptre (1977). Plumptre, himself a participant in the discussions, clearly establishes that these men were motivated not only by a large conception of what the shattered world of the 1940s required, but also by a clear vision of Canadian interests. Similar thoughts are conveyed by another participant, Wilgress (1963; 1967). Among the other Canadians who participated in the various discussions could be included Louis Rasminsky, Clifford Clark, Hector McKinnon, Norman Robertson and John Deutsch.
6. It is not necessary here to consider the origins of the system of multilateral cooperation which was advanced by the United States and Britain in the closing stages of the war. It was based on the ideas of many men, but particularly John Maynard Keynes of Britain and Harry Dexter White, Cordell Hull and Will Clayton of the United States, and on the experience of both countries with the League of Nations and in their bilateral trade and monetary negotiations in the 1930s. A seminal document in this process was the Atlantic Charter issued by Churchill and Roosevelt in 1941 which read in part:

   > *Fourth*, they will endeavour, with due respect for their existing obligations, to further the enjoyment of all States, great or small, victor or vanquished, of access, on equal terms, to the trade and to the raw materials of the world which are needed for their economic prosperity;
   >
   > *Fifth*, they desire to bring about the fullest collaboration between all nations in the economic field with the object of securing, for all, improved labour standards, economic advancement, and social security;
7. See, for example, Jackson (1969); Dam (1970); Canada, Department of External Affairs (1983b); and Stone (1984).
8. Guindy (1980, p. 9).
9. Canada's involvement with the IMF is well told in Plumptre (1977).
10. The international civil servants who service the GATT, for example, remain employees of the Interim Commission for an International Trade Organization (ICITO), and it is ICITO which has a headquarters agreement with the Swiss government and which in 1981 appointed Arthur Dunkel to be the third director general of the GATT.
11. Quoted in *We the Peoples . . . Canada and the United Nations 1945—1965* (Ottawa, 1966, p. 82).
12. Preamble to the constitution of the FAO.
13. A complete description can be found in the very useful *United Nations Handbook*, prepared by the New Zealand government and periodically brought up to date and reissued.
14. Haberler (1964) demonstrates the growing integration of the world economy in broad historical perspective from the early 18th century on. The past two and a half centuries have seen a steady process of integration with only one exception: the period between the two world wars. Integration was a national phenomenon until the mid-19th century and then became an international phenomenon.
15. See Ostry (1984, pp. 533–60).
16. Ritchie (1983, pp. 78–79).

17. In this context, it should perhaps be noted that a good deal of Canadian trade policy activity is devoted to moving the U.S. in a constructive direction, a policy stance encouraged by U.S. trade officials wary of being squeezed between narrow sectoral (often protectionist) interests and broad foreign policy considerations. Poor policy choices in the United States make it difficult for the Canadian government to resist narrow, protectionist policies.
18. For a detailed assessment of these proposals, see Hart (1985).
19. The European Community, or Common Market, consisted in 1984 of Ireland, the United Kingdom, France, Italy, Greece, the Federal Republic of Germany, Denmark, the Netherlands, Belgium and Luxembourg. The European Free Trade Association (EFTA) countries (Sweden, Norway, Finland, Austria, Switzerland and Portugal) are linked to the EC by means of an industrial free trade agreement. Spain, Turkey and the Mahgreb countries are linked by association agreements, considered by some to be a sort of membership-in-waiting. The former European colonies in Africa, the Caribbean and the Pacific are linked by means of the aid and trade Lomé Convention. The Community was established as a result of the integration in 1965 of the separate but related communities established earlier: the European Coal and Steel Community (ECSC) was formed in 1952, the European Economic Community (EEC) was established by the 1957 Treaty of Rome and the European Atomic Energy Community (EURATOM) was established in the same year. Various institutions link the various elements together, including the Commission, the Council of Ministers, the European Parliament and the European Court. Of these, the Commission is the most important for Canada as it is the Community's executive body, responsible for foreign commercial policy. It is supported by an army of bureaucrats in Brussels.
20. It has been estimated that as a result of European integration, coupled with imitator association and free-trade agreements, as well as trade involving non-GATT members, less than 50 percent of world trade is now fully under GATT rules. These arrangements were forged pursuant to GATT rules but once in place, GATT rules for trade among members are of little consequence.
21. Tumlir (1977, p. 11).
22. See, for example, Morici, Smith, and Lea (1982); Jenkin (1983); and Canada, Department of External Affairs (1983b).
23. Canadians have for more than a decade now been subjected to a noisy academic debate, reflected in editorials in the popular press, about whether or not Canada should develop an overt industrial strategy. Such a strategy would provide a framework within which to realize Canada's full economic potential. Americans have recently begun a similar debate. Common to both debates is the example of Japan, which supposedly achieved its economic miracle because it had a master plan. French (1980) provides a fascinating insight into how cabinet ministers and senior officials were, during the 1970s, drawn into supporting the position of one group or another, each finding a champion in a federally established agency. The Science Council, for example, advanced a strategy based on intervention and the development of "technological sovereignty" and found supporters among Canadian nationalists of various stripes. The Economic Council proposed no strategy but defended free trade and competitiveness through further integration into world markets. It found favour among internationalists and continentalists. The U.S. debate is summarized by Blumenthal (1983).
24. Lalonde (1982), in a panel discussion attended by a group of international journalists on the occasion of the annual meeting of the IMF in Toronto.
25. In modern governments, ministers, bureaucrats, departments, agencies, etc., are rewarded for being innovative and for seeking increased jurisdiction and/or resources; there are few rewards for reducing jurisdiction and the need for resources; there is little praise for ably and responsibly managing existing programs. Such a system is bound to produce false starts, changes in direction and abandoned programs. Governments are good at launching new programs, new instruments and new policies; not so good at running existing programs; and terrible at openly burying bad programs. Change, with accent on the new, is thus the order of the day.

26. Many other OECD countries face similar adjustment challenges. The established industrialized countries must adjust existing industrial capacity by adopting new and emerging technologies in order to compete. Current rigidities are also reflected in their approach to market access and their willingness to ignore selected GATT obligations.
27. Gerald Bouey to the Canadian Chamber of Commerce, September 21, 1982. Bank of Canada typescript.
28. The economic case favouring subsidies over tariffs stems from the fact that subsidies stimulate production, exports and consumption, whereas tariffs are meant to restrict imports and stimulate only domestic production. Subsidized goods, when competing with imported goods or, when exported, goods produced elsewhere, will find their natural market price and consumption is not curtailed. Tariffs, on the other hand, raise prices and thus tend to curb consumption. Canadian users of steel, for example, pay more for Canadian-made steel than U.S. users of that same steel. Canadian producers price up to the tariff in Canada but must meet the world price in the United States. For a useful discussion of this issue see Dam (1970, pp. 132–47).
29. Export Development Program, Program for the Advancement of Industrial Technology, Industry and Labour Adjustment Program, Canadian Industrial Renewal Board, Atlantic Regional Development Agreement, General Adjustment Assistance Program, Footwear and Tanning Adjustment Program, Department of Regional Economic Expansion, Industrial Design Assistance Program, Regional Development Incentives Program, General Development Agreement, Special Development Agreements, Agricultural and Rural Development Program, Pharmaceutical Industry Development Program, Fashion Design Assistance Program, Promotional Projects Program, Program for Export Market Development, Canadian Commercial Corporation, Committee for Industrial and Regional Benefits, Shipbuilding Industry Assistance Program, Canada Development Corporation, Canadian Investment Development Corporation, Cape Breton Development Corporation.
30. Introduction of an injury test into U.S. law for dutiable products was a major Canadian objective in the Tokyo Round. The value of this concession became apparent when all of the six findings were dismissed later in 1980 for failure to prove injury.
31. Formally known as the Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade. For both U.S. practice and attitudes and the Tokyo Round negotiations, see Grey (1982).
32. A description of the EDC's various facilities can be found in Canada, Department of External Affairs (1983b, pp. 162–65).
33. For a discussion of the barriers to interprovincial trade in agriculture see Haack, Hughes, and Shapiro (1981).
34. For a detailed discussion of the legal arguments and other modalities involving the application of Article XIX, see Jackson (1969, chap. 23); and GATT Document L/4679 of July 5, 1978, *Modalities of Application of Article XIX*. Other provisions of the GATT which have a safeguard effect or which may condition the nature of a safeguard measure include Article VI (governing the imposition of anti-dumping and countervailing duties), XI (governing restrictions to safeguard agricultural standards or production controls), XII (to safeguard the balance of payments), XIII (governing the non-discriminatory application of quantitative restrictions), XVIII (to safeguard economic development in developing countries), XXV (waivers from obligations) and XXVIII (the negotiation of bound concessions). This section deals in detail only with the types of measures envisaged in Article XIX.
35. Article XXXV allows one contracting party to declare that it does not consider the GATT to constitute its trade agreement with another contracting party, particularly at accession, and thus its bilateral trade not subject to GATT provisions. The Protocol of Provisional Application provides that contracting parties will apply Part II of the GATT insofar as it is consistent with pre-existing legislation.
36. This section is not concerned with the complete system of contingency or conditional protection, which also includes anti-dumping and countervailing duties. Special duties are often the first refuge of the producer seeking to avoid adjustment. If they do not work, the next stage is an emergency quota or surtax to protect his industry from serious injury.

37. See OECD (1983).
38. In the advanced industrialized countries, there is also a curious bias that new jobs must be found in the goods-producing sector — likely to be an elusive dream. In the United States and Canada, for example, some 70 percent of the workforce is now employed in the service sector, which in turn now accounts for 65 percent of GNP. In the past decade four out of five new jobs have been found in this sector. Evidence also suggests that this sector has been the most dynamic and innovative and most ready to adjust to changing competitive conditions. Yet most government assistance programs are geared to goods-producing sectors where the end products can be seen and measured.
39. The final negotiating text of the Tokyo Round (Document MTN/SG/W/47 of April 11, 1979) elaborated a detailed code of interpretation and supplementary rules and procedures regarding the application of Article XIX. The key provisions of W/47 related to the criteria for establishing serious injury, domestic procedures, conditions to which any action would have to conform, the nature of any action, limited selective application, degressivity, notification, consultation, surveillance, dispute settlement, and response to any measure by affected parties.
40. Canada took the view that while non-discrimination should continue to be the norm, occasional selective action could be contemplated but under strict rules requiring consent or multilateral surveillance. The U.S. view that discrimination should be permitted when the parties involved agreed (so-called consensual discrimination) did not meet the EC view that it could act unilaterally to discriminate. Even prior multilateral authorization of unilateral discrimination did not satisfy the EC. The economic and political cases against selectivity are persuasive. Selectivity allows a country to bar the most efficient, most competitive producers from its market, subjecting domestic producers only to competition from less efficient producers. For many products, the more efficient or lower cost producers tend to be located in weaker, less established economies less able to defend their trade interests. Selectivity thus re-introduced power into trade relationships, the very condition multilateral rules were meant to overcome.
41. GATT document L/5151 of May 1981. The latter provisions were adopted during the Tokyo Round to provide for more transparent and regular resort to dispute settlement.
42. Similarly, the decision by the Canadian government to re-impose a global quota on leather footwear in 1982, without a finding of serious injury, constituted an ominous disregard for both domestic and international procedures. In May 1984 the government again extended the footwear quota to May 1986 and asked the Anti-dumping Tribunal again to review the state of the industry. By the time this extension terminates, "temporary" quotas will have been in place for nine years.
43. The EC continues to apply discriminatory measures, justifying these under Article XXXV, the Protocol of Provisional Application and their instruments of accession to the GATT. The problem of the state-trading countries is a difficult issue for the GATT and has never been fully resolved. Annual Working Parties examine whether or not these countries are complying with their accession commitments.
44. Wyndham-White (1975).
45. Following the Tokyo Round, the government reviewed its safeguard procedures and made public some suggestions for improvement in Canada, Department of Finance (1980). The proposals were studied by a special committee of Parliament which reported in June 1982: *Report on the Special Import Measures Act*, Sub-Committee on Import Policy, Standing Committee on Financial, Trade and Economic Affairs, House of Commons, June 1982. A bill incorporating a new Canadian Special Import Measures Act was introduced in Parliament in December 1983 and passed into law in June 1984.
46. In certain cases, economic theory shows that the exporting country assumes some of these costs.
47. For an interesting early account of the legislation, see Kaliski (1963).
48. Canada, Department of External Affairs (1983a, p. 37).
49. These included U.S. safeguard measures on specialty steel, industrial fasteners and preserved mushrooms, and Canadian measures on footwear.

50. This article provides for consultation leading to dispute settlement procedures when one contracting party believes the actions of another have nullified and impaired benefits accruing to it under the General Agreement.
51. The Arrangement Regarding International Trade in Textiles, popularly known as the Multi-Fibre Arrangement or MFA.
52. Much of the information in this chapter is based on the author's close association with Canadian textile import policy in the period 1976–82.
53. The arrangement with China was initially for two years; a third year was added in 1979 following Canadian efforts to solve a Chinese export administration problem.
54. The decision to extend the MFA to July 31, 1986 was based on a Canadian suggestion to Pakistan. Smaller exporting countries were frustrated by the EC's ability to use the difficulty of getting home for Christmas as a small but effective weapon. The next round will involve the August holiday, sacred only to the EC.
55. See, for example, the various arguments described in Cline (1982).
56. McNamar (1982).
57. Canada, Department of External Affairs (1983b, pp. 61–125). The same theme is struck in the Economic Council's *The Bottom Line* (1983), and by Beckman's (1982) report for The Conference Board.

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